



NORTH CAROLINA GENERAL ASSEMBLY

2025 Session

Legislative Fiscal Note

Short Title: Prescription Drug Expenses Tax Deduction.
Bill Number: House Bill 1074 (First Edition)
Sponsor(s): Rep. Reeder, Rep. Chesser, Rep. Campbell, and Rep. Paré

SUMMARY TABLE

FISCAL IMPACT OF H.B. 1074, V.1 (\$ in millions)

	<u>FY 2026-27</u>	<u>FY 2027-28</u>	<u>FY 2028-29</u>	<u>FY 2029-30</u>	<u>FY 2030-31</u>
State Impact					
General Fund Revenue	(84)	(79)	(72)	(77)	(82)
Less Expenditures	-	-	-	-	-
General Fund Impact	(84)	(79)	(72)	(77)	(82)
NET STATE IMPACT	(84)	(79)	(72)	(77)	(82)

TECHNICAL CONSIDERATIONS: See Technical Considerations Section

FISCAL IMPACT SUMMARY

The Fiscal Research Division (FRD) estimates House Bill (H.B.) 1074, Prescription Drug Expenses Tax Deduction, would reduce State personal income tax (PIT) revenue by \$84 million in FY 2026-27. Over the next five fiscal years, FRD estimates this bill would reduce PIT collections by nearly \$400 million in total.

Under current law, State taxpayers that itemize deductions are allowed to deduct medical and dental expenses, including prescription drug costs, that exceed 7.5% of their federal adjusted gross income (AGI). This bill would establish a new deduction that does the following:

1. Allows all State taxpayers, including those taking the standard deduction, to deduct up to \$5,000 in prescription drug costs.
2. Gives taxpayers who itemize deductions the option of deducting either up to \$5,000 in prescription drug costs or the amount of total taxpayer medical and dental expenses that exceed 7.5% of their AGI.

FISCAL ANALYSIS

Currently, approximately 2% of North Carolina State taxpayers deduct medical or dental expenses, and only taxpayers who itemize deductions are eligible to deduct these expenses. This bill would allow taxpayers to deduct prescription costs before surpassing the existing threshold required to

be eligible to deduct prescription drug cost as a qualifying medical or dental expense and would expand the deduction of prescription drug costs to taxpayers taking the standard deduction.

There is insufficient tax return data available to develop an estimate of prescription drug costs in the State that would be deductible under the bill. State data on taxpayer medical expenses is only available from taxpayers that itemize deductions. This cohort comprises less than 10% of all taxpayers. Additionally, our research found no other states with a prescription drug deduction similar to H.B. 1074.

Due to the data constraints, FRD used data from the U.S. Department of Health and Human Services (DHHS) on total Statewide out-of-pocket prescription drug costs. Then, FRD estimated the average annual prescription drug costs per taxpayer and assumed each taxpayer would deduct the average amount of prescription drug costs. Lastly, FRD accounted for growth in State medical expenses, growth in the number of taxpayers, anticipated changes in the personal income tax rate, and the estimated amount of prescription drug expenses deducted under existing law.

Overview of the Existing Itemized Deduction of Medical Expenses

Under current law, North Carolina follows the federal treatment for the deduction of medical expenses, which includes prescription drug costs. Only State taxpayers that itemize deductions are allowed to deduct medical expenses. These taxpayers may deduct only healthcare expenses that exceed 7.5% of their federal adjusted gross income (AGI).

Two example scenarios of hypothetical taxpayers with healthcare expenses are presented in Table 1 below. Taxpayer A is eligible to take an itemized deduction for some of their medical expenses while Taxpayer B is ineligible due to the 7.5% AGI threshold in effect under current law.

Table 1: Hypothetical Taxpayer Scenarios with Medical Expenses

Category	Taxpayer A	Taxpayer B
Federal AGI	\$100,000	\$100,000
Medical Expenses	\$10,000	\$7,500
7.5% of AGI	\$7,500	\$7,500
Amount Eligible for State Itemized Deduction	\$2,500	\$0

North Carolina Prescription Drug Expenditures

U.S. Department of Health and Human Services (DHHS) data indicates North Carolina residents spent roughly \$15.3 billion on prescription drugs in 2020, the most recent year for which data is available. This figure includes the total amount spent by insurers, individuals, and all medical entities on prescription drugs. To estimate the amount of prescription drug costs eligible for deduction under the bill, FRD determined the share of total drug costs attributable to out-of-pocket consumption.

Based on DHHS data, approximately 12% of prescription drug costs are paid by households out-of-pocket nationwide. Consequently, FRD estimates North Carolina out-of-pocket drug spending in 2020 totaled approximately \$1.8 billion in 2020 (\$15.3 billion in total spending x 12% = roughly \$1.8 billion).

FRD used proprietary historical and forecasted data from Moody’s Analytics household healthcare consumption to account for growth in the overall consumption of prescription drugs and for price inflation. Using this data, FRD estimates there will be roughly \$3.2 billion in out-of-pocket prescription drug costs in 2026. The table below shows the estimated total amount of prescription drug costs for each year of the projection period.

Table 2: Estimated North Carolina Out-of-Pocket Prescription Drug Costs

Tax Year	Amount (\$ in billions)
2026	\$3.2
2027	\$3.4
2028	\$3.7
2029	\$3.9
2030	\$4.1

Taxpayer Out-of-Pocket Prescription Drug Expenditures

FRD is unable to determine to what extent estimated out-of-pocket spending is spread across North Carolina’s approximately 5.4 million personal income returns filed by personal income taxpayers. Therefore, in this analysis FRD assumes each taxpayer deducts the same amount of out-of-pocket spending. For example, in 2026, each taxpayer is assumed to have roughly \$600 in deductible prescription drug costs (\$3.2 billion in total out-of-pocket spending / 5.4 million State taxpayers = roughly \$600 in out-of-pocket spending per taxpayer). Table 3 below shows the estimated out-of-pocket prescription drug costs per taxpayer.

Table 3: Estimated Out-of-Pocket Prescription Drug Costs Per Return

Tax Year	Estimated Number of Total Returns	Estimated Number of Total Returns with Taxable Income	Estimated Amount of Prescription Drug Costs Per Return
2026	5.4 million	4.1 million	\$600
2027	5.5 million	4.3 million	\$630
2028	5.6 million	4.3 million	\$660
2029	5.7 million	4.4 million	\$690
2030	5.8 million	4.5 million	\$720

Using taxpayer historical data, FRD estimates approximately 77% of taxpayers will have taxable income through the projection period and assumes only taxpayers with an existing tax liability would be eligible to deduct prescription drug costs.

Estimated Prescription Drug Expenses Deducted under H.B. 1074

FRD assumes some taxpayers would continue to use the existing itemized medical expense deduction to deduct some prescription drug costs. DHHS data indicates prescription drug costs comprise roughly 10% of the total amount spent on personal healthcare consumption. Therefore, FRD assumes 10% of the amount deducted under the current itemized medical deduction is attributable to prescription drug costs.

Historical taxpayer data on the existing itemized medical deduction and growth in Moody's estimates of healthcare consumption were used to estimate the amount of prescription drug costs deductible under current law in Table 5. Additionally, FRD multiplied the estimated number of taxpayers with taxable income by the estimated amount of prescription drug costs by taxpayer to product estimates of the costs deducted under the bill draft.

The amount of prescription drug costs anticipated to be deducted by taxpayers using the existing itemized medical deduction was subtracted from the total amount of deductible prescription drug costs estimated to be deductible under the bill. Table 5 below shows the estimated amount of prescription drug costs deducted under current law and the bill.

Table 5: Estimated Total Prescription Drug Expenses Deducted, \$ in billions

Tax Year	Current Law	Bill Draft	Difference between Bill Draft and Current Law
2026	\$0.4	\$2.5	\$2.1
2027	\$0.4	\$2.7	\$2.3
2028	\$0.4	\$2.8	\$2.4
2029	\$0.4	\$3.0	\$2.6
2030	\$0.5	\$3.2	\$2.7

Finally, to estimate the fiscal impact, FRD multiplied the amount of newly deductible medical expenses presented in the "Difference" column in Table 5 by the applicable personal income tax rate for each tax year. For example, in 2026, H.B. 1074 is estimated to reduce revenue by an estimated \$84 million, (\$2.1 billion in additional deductions x 3.99% tax rate = \$84 million). The estimated fiscal impact for each year may be found in the Summary Table on the first page of this analysis.

This analysis cannot account for the unique situation of each taxpayer. For example, some taxpayers with dependents or who file jointly may deduct more than \$600 on average in 2026, and some taxpayers may be eligible for other credits or deductions that reduce their final tax liability.

TECHNICAL CONSIDERATIONS

State healthcare consumption and medical costs, the actual growth in the number of State taxpayers, or the actual amount of medical costs claimed per return may differ from the

assumptions used in this analysis, resulting in the fiscal impact being different from the estimates provided.

FRD assumes taxpayers will deduct these prescription costs when finalizing their tax returns each year. For example, prescription drug costs incurred in 2026 will be deducted in the first part of 2027 as most taxpayers finalize their returns.

DATA SOURCES

U.S. Department of Health and Human Services, Centers for Medicare and Medicaid Services, The North Carolina Department of Revenue, Internal Revenue Service Publication 502, and Moody's Analytics.

LEGISLATIVE FISCAL NOTE – PURPOSE AND LIMITATIONS

This document is an official fiscal analysis prepared pursuant to Chapter 120 of the General Statutes and rules adopted by the Senate and House of Representatives. The estimates in this analysis are based on the data, assumptions, and methodology described in the Fiscal Analysis section of this document. This document only addresses sections of the bill that have projected direct fiscal impacts on State or local governments and does not address sections that have no projected fiscal impacts.

CONTACT INFORMATION

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