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LEADERSHIP'S TAX PLAN REINFORCES INEQUITIES IN HEALTH AND PENSION COVERAGE

Tax Cuts Primarily Benefit High-Income Households and Could Reduce Health and Pension Coverage for Low- and Moderate-Income Workers

Congress will shortly consider a significant tax package developed by the House and Senate Republican leadership. Despite some beneficial provisions in the bill, such as the $1 increase in the minimum wage phased-in over the next two years, the bill's tax provisions will primarily benefit those with high incomes. In developing the package, the leadership dropped bipartisan provisions — such as the retirement savings tax credit and the small business tax credit adopted by the Senate Finance Committee and the Medicaid access provisions adopted by the House Commerce Committee — that could have benefitted low- and middle-income workers. Rather, they retained provisions benefitting primarily those that already have health insurance and pension coverage. Even more worrisome is that some of these provisions could make it more difficult for low- and moderate-income workers to get health insurance and pension coverage through their jobs.

The Joint Committee on Taxation estimates the cost of the package to be $240 billion over 10 years. But when combined with anticipated discretionary appropriations, the repeal of the telephone excise tax, and new health benefits for military retirees, as well as the resulting interest costs, this bill brings the 10-year cost recent of congressional actions to about $850 billion (see box at the end of the paper). This Congress will therefore use a substantial share of the available surplus without addressing key priorities, such as reducing the ranks of the uninsured or funding prescription drug benefits. The benefits of the leadership's plan remain focused on those who have benefitted the most from the economic boom, offering little to those who continue to struggle to get ahead.

- Nearly two-thirds of the tax cuts in the bill go to the 20 percent of taxpayers with the highest incomes. The top five percent of taxpayers receive a greater share of the tax cuts than the bottom 80 percent. Thus the benefits of the bill are concentrated on those that already have high rates of health insurance and pension coverage. These estimates were calculated by the Institute for Taxation and Economic Policy.

- The bill's health insurance deduction is expensive and poorly targeted. This deduction is most valuable to those in the highest tax brackets, yet those most in need of coverage have no tax liability or are in the lowest (15 percent) bracket. Taxpayers with incomes too low to pay income taxes would receive no assistance from this deduction. For most taxpayers in the 15 percent bracket, the 15-cents-on-the-dollar subsidy that the deduction provides is unlikely to be sufficient to make costly health insurance affordable.

- According to the Joint Tax Committee, approximately 94 percent of the cost of the health insurance tax deduction would go to subsidize taxpayers that already have health insurance, with only 6 percent of the tax benefits going to further the goal of extending health insurance coverage to the uninsured.

- The Council of Economic Advisers, among other researchers, found that tax deductions are a very inefficient way of extending coverage to the uninsured. A more cost-effective approach is the Administration's FamilyCare plan, which, at a lower cost, would provide coverage to more than twice the number of uninsured than the proposed tax deduction.

- Because the health care tax deduction would provide a far deeper percentage subsidy for purchasing health insurance to higher-paid business owners and executives than to lower-wage earners, it could encourage some small business owners to drop group coverage (or not to institute it in the first place) and to rely on the deduction for their own coverage. As a result, some workers could be forced to buy more costly and less comprehensive insurance on the individual market, and the ranks of the uninsured and under-insured could rise.

- The bill also includes tax deductions for long-term care insurance and long-term care expenses that would provide the largest benefit to higher-income taxpayers. Most low- and middle-income taxpayers would get no more than a 15 percent subsidy; this is too little to enable most of these families to afford costs related to long-term care.

- Most of the bill's pension benefits would accrue to higher-income workers who already enjoy high rates of pension coverage. An analysis by the Institute for Taxation and Economic Policy of the bill's pension and IRA provisions found that 77 percent of the benefits would go to the 20 percent of Americans with the highest incomes. In sharp contrast, the bottom 60 percent of the population would receive less than five percent of these tax benefits.

- Moreover, the bill would likely lead to reductions in pension coverage for some low- and middle-income workers and employees of small businesses. For instance, it would weaken "non-discrimination" and "top-heavy" rules that ensure company pension plans treat low-income workers fairly and are not skewed in favor of highly compensated workers. It also increases the IRA contribution limits to $5,000, which could make IRAs more attractive than company pension plans for owners of small businesses, possibly leading them to drop plans that benefit their workers.

Impact of the Tax Bill

The Joint Committee on Taxation estimates the cost of the tax bill to be $240.4 billion between 2001 and 2010. Most of these benefits will flow to those with the highest incomes and with the highest levels of health insurance and pension coverage. The Institute on Taxation and Economic Policy estimates that 63.8 percent of the bill's tax benefits will go to the highest 20 percent of taxpayers, as shown in the box below. In contrast, lower- and moderate-income taxpayers (those in the bottom 60 percent), who are most likely to be without health insurance and pension coverage, would receive less than 20 percent of the bill's benefits.

Effects of the Taxpayer Relief Act of 2000

Income Group	Income Range	Average Income	% of Total Tax Cut
Lowest 20%	Less than $14,000	$8,600	2.1%
Second 20%	14,000-24,000	18,800	6.0%
Middle 20%	24,000-39,000	31,100	11.0%
Fourth 20%	39,000-65,000	50,700	17.0%
Top 20%	65,000 or more	147,000	63.8%
ALL		$50,800	100.0%
ADDENDUM			
Bottom 60%	Less than $39,000	$19,500	19.1%
Top 5%	More than $130,000	$329,000	40.1%
Top 1%	More than $319,000	$915,000	24.3%

Source: Institute on Taxation and Economic Policy Tax Model, October 27, 2000.

Health Provisions

The bill includes several health-related provisions, costing $88.3 billion over 10 years. A health insurance tax deduction would be available to taxpayers that do not participate in employer-sponsored health plans or that pay more than half of the premiums of employer-sponsored insurance. The bill also includes two tax deductions related to long-term care. One tax deduction would be for 100 percent of the cost of long-term care insurance, while the other would be for expenses related to long-term care. All of these health-related tax deductions would be available to taxpayers that do not itemize.

The health insurance and long-term care proposals are tax deductions rather than tax credits. As a result, they are more valuable to high-income taxpayers, who are in the higher tax brackets. As deductions, they offer no benefits to taxpayers whose incomes are too low to pay income taxes. For those with moderate incomes in the 15 percent tax bracket, the subsidy provided by the deductions is worth only 15 cents for every dollar spent. This low subsidy rate is unlikely to make the difference for moderate-income families, who would still be left with 85 percent of these expensive health and long-term care costs. In contrast, the subsidy is worth more than twice as much to those in the top brackets (the 31 percent, 36 percent and 39.6 percent brackets). These higher-income families are better able to afford these costs, even without the deduction.

The health insurance deduction would provide little subsidy to most workers who currently are uninsured. Census data show that 93 percent of all uninsured individuals either have incomes too low to incur income tax liability or pay income tax at the 15 percent marginal rate.[1] Rather than helping uninsured workers who cannot afford the premiums required to obtain adequate health coverage, such a deduction would, by and large, provide its principal benefits to individuals in higher tax brackets who already purchase individual insurance.

While few low- and moderate-income workers would benefit, some could be harmed by the proposal. The proposed new health insurance deduction would allow small business owners or more highly-paid employees to purchase insurance for themselves, using the more generous subsidy the deduction provides for those in higher tax brackets, without the necessity of providing coverage for lower-paid employees. As a result, the deduction could provide an incentive for some small business employers to drop group coverage, or for some owners newly launching small businesses to decline to offer such coverage. To the extent this occurs, it would adversely affect some of the same workers whom the minimum-wage legislation is supposed to help.

A Joint Committee on Taxation estimate of the proposal indicates that the health insurance tax deduction would help 1.6 million uninsured people gain health coverage (when the 100 percent deduction is first effective). Yet the same estimate states that a total of 26 million people would benefit from the deduction. Thus, the uninsured would represent just over 6 percent of the total number of beneficiaries of the deduction (1.6 million out of 26 million). As a result, 94 percent of the deduction's annual cost, once it is fully effective, would be dedicated to providing a tax cut to those that already have health insurance.

Recent research by the Council on Economic Advisers and others shows that a far more cost-effective way to assist the uninsured, particularly uninsured children, would be to extend publicly-funded health insurance coverage to low-income parents. The Administration's FamilyCare plan relies on this approach. The FamilyCare proposal would provide additional funds to states under the State Children's Health Insurance Program (SCHIP) and allow states to use these funds to extend coverage to the parents of children being insured under Medicaid and SCHIP. Both poor and near-poor families could benefit, with the approach expected to provide

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[1] These data show that 18 million uninsured individuals — 43 percent of all of the non-elderly uninsured — owe no income tax; their earnings are too low for them to incur an income tax liability. These uninsured individuals would receive no benefit from a tax deduction. Another 20 million uninsured individuals — 50 percent of the non-elderly people without health insurance — pay income tax at a 15 percent marginal tax rate. A deduction would provide these taxpayers with a subsidy equal to 15 percent of the cost of insurance not covered by an employer. General Accounting Office, Letter to The Honorable Daniel Patrick Moynihan, June 10, 1998, GAO/HEHS-98-190R, Enclosure II. The analysis is based on the 1996 Current Population Survey. No similar analysis based on more recent CPS data is available.

“Medicare, Medicaid and SCHIP Benefits Improvement and Protection Act”

The "BBA give back" agreement reached between House and Senate Republican leaders has been rolled into the larger tax legislation. Earlier this month, the House Commerce Committee approved, on a bipartisan basis, a BBA give back bill. The leadership BBA bill deletes two critical provisions from the Commerce package. These provisions were designed to enhance state flexibility in extending coverage to low income pregnant women and children who are legal immigrants and in enrolling eligible low-income families and children in Medicaid and SCHIP coverage.

The House Commerce Committee version would have allowed states to restore Medicaid and SCHIP eligibility to low-income legal immigrants who are pregnant women or children two years after they enter the U.S. Currently, immigrants are excluded from these programs for five years after they enter the U.S. Bipartisan legislation was introduced this year in both the House and Senate (Diaz-Balart/Waxman and Chafee/Graham respectively), based on an Administration budget proposal, that would give states the option to restore coverage immediately. Restoring Medicaid and SCHIP eligibility to legal immigrants will help ensure that they receive vital services like prenatal care, immunizations and other services. Furthermore, the changes are important in helping to reverse an unintended consequence of the welfare legislation, in which U.S.-born citizen children in immigrant families also lost Medicaid and SCHIP coverage because of confusion about complex eligibility rules.

The current version also drops a set of critical proposals included in the Commerce Committee bill that would provide states with additional flexibility to enroll more eligible low-income children and families in health care coverage.

The conference version would have improved health care coverage for families leaving welfare for work. At present, most families leaving welfare for work are eligible for up to one year of transitional health care coverage through Medicaid (Transitional Medical Assistance or TMA); but, TMA is scheduled to expire on September 30, 2001. The Commerce bill extended the availability of Transitional Medical Assistance through September 30, 2002, creating time for Congress to adopt a permanent fix. It also allowed states to drop burdensome reporting requirements imposed on families receiving TMA. The option, recommended by the General Accounting Office, would help assure that unnecessary paperwork does not keep working families from securing the health care coverage for which they are eligible.

Another provision in the current version would have given states the option to allow schools and other new entities to enroll children in coverage on a temporary basis. Building on the existing "presumptive eligibility" option in Medicaid, the Commerce proposal would have allowed states to give schools (and other new entities that work extensively with low-income families) authority to enroll eligible children in coverage on a temporary basis while they complete the full Medicaid application process. Given that some four million low-income uninsured children — the vast majority of whom are eligible for Medicaid or SCHIP — already participate in the National School Lunch Program, the option to involve schools more directly in the enrollment of children in coverage represents a particularly important tool for reducing the number of uninsured children.

insurance ultimately to four million uninsured people, including additional children brought in with their parents, based on Administration estimates. By contrast, the Joint Committee on Taxation estimates that just 1.6 million uninsured — or less than half as many as under FamilyCare — would gain coverage as a result of the proposed tax deduction.

The bill's tax deductions for long-term care — one for the cost of long-term care insurance premiums and the other for expenses for long-term care provided to a relative — do not address the major problems relating long-term care. The proposed deductions would not help most middle-income people and could exacerbate the inequities in access and affordability that currently exist with regard to long-term care.

Three-quarters of all taxpayers, including most moderate-income taxpayers, pay federal income taxes at no higher than the 15 percent marginal tax rate. For this three-quarters of all taxpayers, a deduction would provide at most a subsidy of 15 percent of the cost of purchasing long-term care insurance or of the cost (up to $10,000 in 2008) of providing long-term care for a relative. A 15 percent subsidy is unlikely to make these costs substantially more affordable for moderate-income taxpayers. The primary beneficiaries of these proposed deductions are likely to be higher-income taxpayers. A subsidy of 36 percent, for example, is more likely to be high enough to make the purchase of long-term care insurance attractive and the cost of long-term care more affordable.

Pension Provisions

The bill's pension provisions, which cost $63.8 billion over 10 years, are promoted as expanding pension coverage for working Americans. But while these pension provisions include some useful changes, their principal impact would be a major expansion of pension-related preferences for high-income individuals. Moreover, the bill excludes bipartisan provisions from the pension bill reported by the Senate Finance Committee. Those provisions would have offered a retirement savings tax credit to low- and moderate-income workers and a tax credit to small businesses to promote pension coverage for their employees. Although these provisions were dropped, denying benefits to those low- and middle-income workers who are the least likely to have adequate pension coverage, the package retained provisions that benefit those who already have the most generous pension coverage.

The main thrust of the legislation is to relax various rules intended to limit opportunities for high-income executives to enjoy pension benefits without providing similar benefits to rank-and-file employees. The apparent theory behind the proposals' changes in this area is that by liberalizing the rules for higher-income executives, the legislation will lead more businesses to adopt pension plans and thereby help their middle- and lower-income employees. However, no credible empirical evidence supports this theory, and analysis of the provisions in the conference bill suggests that the "trickle-down" approach comes at a steep price. These provisions, which are shown in the box, could lead to reductions in pension coverage among ordinary workers.

For instance, the bill's provisions to weaken "non-discrimination" and "top-heavy" rules could harm low- and moderate-income workers. Under current law, tax-preferred pension plans must not discriminate in favor of highly compensated employees. The nondiscrimination rules play an important role in ensuring that tax preferences for pension plans serve the public purpose of boosting pensions among a wide array of workers, rather than just among highly compensated workers. The legislation, however, directs the Secretary of the Treasury to issue regulations easing these rules.

Similarly, certain "top-heavy" protections apply to pension plans that, while meeting the non-discrimination rules, deliver most of their benefits to key employees, generally company officers and owners. These protections require firms to take additional steps to protect middle- and low-income workers in such circumstances, through accelerated vesting and certain minimum contributions or benefits. The tax bill would significantly weaken the top-heavy safeguards by redefining who qualifies as a "key" employee, by selectively counting and not counting certain pension contributions in evaluating the top-heavy criteria, and by changing the rules governing the division of assets among family members. As a result, companies could offer significant pensions benefits to some employees, but would no longer be required to offer similar benefits to other covered employees.

In a recent report, the General Accounting Office finds that the top-heavy rules can be important in ensuring a more equitable division of pension tax benefits between ordinary workers and highly paid workers than would otherwise be the case. In the October 2 report, *Private Pensions: "Top-Heavy" Rules for Owner-Dominated Plans*, the GAO also finds that the administrative costs resulting from the top-heavy rules are relatively low.

In addition, the bill's provision to raise the IRA contribution limits from $2,000 to $5,000 (and to $6,500 for those over 50) would benefit only the 4 percent of eligible taxpayers that

Pension Provisions in the Tax Bill that Favor High-Income Taxpayers

Contributions to 401(k) plans	Maximum employee contribution raised from $10,500 to $15,000
Combined employer-employee contributions to defined contribution plans	Requirement that contributions not exceed 25% of pay eliminated Maximum contribution limit raised from $30,000 to $40,000
IRAs	Maximum contribution to IRAs increased from $2,000 to $5,000 per person, and to $6,500 for those over 50
Maximum considered compensation	Increased from $170,000 to $200,000
Annual maximum payment allowed under defined benefit plan	Increased from $135,000 to $160,000 Maximum amounts allowed for early retirees raised
Nondiscrimination rules	Secretary of the Treasury directed to relax these rules
Top-heavy rules	Definitions loosened and so-called "safe harbor" 401(k) plans exempted
Money purchase plans	Reduced incentives to set up money purchase plans. These plans are particularly beneficial to low- and moderate-income workers.

currently contribute the maximum $2,000 amount to an IRA. Those who cannot afford to deposit $2,000 in a IRA cannot deposit $5,000 and consequently would not be affected by an increase in the IRA contribution limit. Furthermore, this provision could *reduce* pension coverage among workers in small businesses. Under the legislation, a small business owner and his or her spouse could deposit a total of $10,000 into their IRAs (or $13,000 if they were older than 50) rather than $4,000 under current law. With the higher limits, the small business owner may not see the need for a company pension plan and may drop such a plan or fail to institute a plan in the first place.

An analysis by the Institute for Taxation and Economic Policy found that the 76.9 percent of the bill's pension and IRA benefits would accrue to the 20 percent of Americans with the highest incomes. More than 42 percent of the pension and IRA tax breaks would go to the five percent of the population with the highest incomes. In sharp contrast, the bottom 60 percent of the population would receive less than five percent of these tax benefits.

It should be noted that this legislation includes some beneficial reforms in the pension laws. For example, the legislation would reduce the maximum vesting period for 401(k) plans to three years, from the current five-year maximum. The bill also simplifies the rules on rolling over account balances from one type of retirement account to another, which may increase pension portability for some workers. The large new benefits for higher-income taxpayers and the potential for harm to low- and moderate-income workers described above, however, are a high price to pay for these improvements.

COST OF LEGISLATION LIKELY TO BE ADOPTED IN THE FINAL DAYS OF THE 106TH CONGRESS

Legislation Congress is passing in the final days of the 106th Congress would consume about $850 billion of the $2.2 trillion in non-Social Security surpluses CBO projected for the next 10 years. (CBO's baseline projections assumed that there would be no changes in laws governing taxes or entitlement spending and that discretionary spending would be maintained at the fiscal year 2000 level, adjusted for inflation.) The major pieces of legislation already enacted or likely to pass Congress would have the following effects on the budget:

- Discretionary appropriations enacted for fiscal year 2001 are likely to total about $640 billion, an amount that is about $30 billion higher than CBO's baseline assumed. If this higher level provided for 2001, adjusted for inflation, is maintained through 2010, discretionary spending will be about $300 billion higher than CBO's baseline assumed for 2001 through 2010.

- Congress has already passed a bill that expands health care entitlement benefits for military retirees covered by Medicare, at a cost of $60 billion in 2001 through 2010. Congress is also considering so-called Medicare Balanced Budget Act (BBA) giveback legislation that would increase payments to Medicare providers and provide some additional benefits for Medicare enrollees. A version of that legislation included in the tax package the House passed on October 26 would cost $73 billion over 10 years, but those costs were almost entirely offset by savings resulting from Medicaid provisions that were also included in the package.

- Congress has already passed legislation repealing the telephone excise tax, at a cost of $55 billion in 2001 through 2010. The Congressional leadership is proposing a package of additional tax cuts that would reduce revenues by an additional $240 billion over 10 years. If that package is enacted, revenues would be reduced by a total of $295 billion over 10 years.

- These spending increases and tax cuts would reduce the size of the surplus and the amount of debt reduction relative to CBO's baseline, thereby increasing debt and interest payments on that debt. Interest payments would be about $190 billion higher over 10 years than CBO's baseline assumes.

Altogether, the legislation described above will cost about $850 billion over 10 years, although that legislation does not deal with any of the most costly proposals (such as eliminating the income tax marriage penalty, repealing the estate tax, reducing the taxation of Social Security benefits received by higher-income elderly taxpayers, providing a Medicare prescription drug benefit, and expanding health insurance coverage for the 43 million Americans without health insurance) that were priorities of either Republicans in Congress or President Clinton and Congressional Democrats.

Cost of Legislation Congress is Likely to Adopt (Relative to CBO's July Baseline)
(In billions of dollars)

	Fiscal Years 2001 - 2010
Discretionary spending at the 2001 level, adjusted for inflation, through 2010	$300
Military retiree health benefits	$60
Tax cuts	$295
Interest	$190
Total cost of legislation likely to be adopted	$845