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POSSIBLE HEALTH INSURANCE DEDUCTION AMENDMENT TO THE PATIENTS' BILL OF RIGHTS OFFERS LITTLE HELP TO THE UNINSURED

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When the Senate considers the Patients' Bill of Rights this week, a floor amendment may be offered that would establish a new tax deduction for health insurance premiums. Supporters of a deduction are likely to argue that it would address the problem of the uninsured by making health insurance more affordable. Analysis shows, however, that such a deduction constitutes a poorly targeted and expensive way to help a tiny portion of the uninsured obtain coverage. Those with low and moderate incomes who are most likely to be uninsured would receive little or no benefit from the deduction. Moreover, the deduction may lead some employers to reduce their contribution to the cost of health insurance or to drop coverage entirely, possibly adding currently covered workers to the ranks of the uninsured.

If an amendment is offered, it may be similar to proposals made in the 106th Congress that would phase in a tax deduction for the full cost of health insurance premiums.[1] The deduction would be available to taxpayers, whether or not they itemize deductions, who pay at least 50 percent of the cost of their health insurance.

- According to an analysis by the Joint Committee on Taxation last year, *approximately 94 percent of the cost of such a 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 cost to the government of each newly insured person would be $4,300, or more than $17,000 for a newly insured family of four.

- The proposed deduction is most valuable to high-income taxpayers; in 2002 the tax subsidy would be worth 10 cents on the dollar for many lower-income taxpayers, but 38.6 cents on the dollar for those in the highest tax bracket. The higher-income taxpayers that would receive the most general subsidy are the very

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[1] A health insurance tax deduction was included in a tax bill the House of Representatives passed last fall (H.R. 1836) and in the version of the Patients' Bill of Rights that the House passed in 1999 (H.R. 2990). Those proposals would phase in the deduction over six years (starting at 25 percent of premium costs and rising to 100 percent). The deduction could be used for the purchase of health insurance in either the individual market or for the taxpayer's share of the cost of employer-based coverage, so long as the taxpayer pays at least 50 percent of the cost of the premium. The Joint Committee on Taxation last year estimated the cost of this proposal between $6 billion and $9 billion over five years and $47 billion and $56 billion over 10 years, depending on whether the deduction takes effect for tax year 2001 or tax year 2002.

taxpayers who benefitted most from the recently enacted tax legislation and who least need a federal subsidy to afford health insurance.

- The deduction is poorly targeted with respect to the uninsured. More than nine of every 10 people without health insurance have no tax liability or are in the lowest two tax brackets (the 10 percent or 15 percent brackets). Taxpayers with incomes too low to pay income taxes would receive no assistance from this deduction whatsoever in purchasing insurance. For example, a married couple with two children would not benefit at all from the deduction unless its income exceeded $21,000. For most taxpayers with somewhat higher incomes that place them in one of the two lowest tax brackets, the 10 cents- to-15 cents-on-the-dollar subsidy the deduction would provide is too small to make insurance much more affordable.

- The deduction may encourage employers to set their contribution levels at 50 percent or less of the cost of health insurance, on the theory that their workers then could take advantage of the deduction. In addition, because the deduction offers a substantial tax subsidy for the purchase of insurance to higher-income business owners and executives, it could encourage some small business owners to drop, or fail to provide, group coverage and to rely instead on the deduction to help defray the cost of their own coverage. As a result, some workers may no longer be able to afford their premiums or could be forced to buy more costly and less comprehensive insurance on the individual market, and the ranks of the uninsured and underinsured could increase.

A far more effective means to expand coverage of the uninsured would be to extend publicly-funded health insurance coverage to low-income parents. In 2000, there were 6.9 million uninsured parents below 200 percent of the poverty line ($29,260 for a family of three). These overwhelmingly are parents in working families. In part because eligibility for parents under Medicaid in the median state is only 66 percent of the poverty line ($9,650 for a family of three), more than one in every three low-income parents — 34 percent — are uninsured. The FamilyCare Act of 2001, bipartisan legislation likely to be introduced this week in Congress, would provide states enhanced federal matching funds to cover the parents of children enrolled in Medicaid and the State Children's Health Insurance program (SCHIP). FamilyCare would not only significantly reduce the number of uninsured working parents but also has the additional beneficial effect of facilitating enrollment of children who are eligible but not yet participating in those programs.

- A report issued last year by the President's Council of Economic Advisers concludes that tax deductions will do little to improve health insurance coverage and that approaches similar to FamilyCare are substantially more effective and efficient at targeting the uninsured.

Deduction is Poorly Targeted

Last year, a Joint Committee on Taxation estimate of the proposed tax deduction indicated it would help 1.6 million people gain health coverage when fully implemented.[2] The same estimate states, however, that a total of 26 million people would benefit from — that is, use — the deduction.[3] Thus, under the JCT estimate, the newly uninsured would represent just over 6 percent of the total number of beneficiaries of the deduction (1.6 million out of 26 million). Some 94 percent of the deduction's annual cost, once it is fully effective, would be dedicated to providing a tax cut to those who already have health insurance.

The JCT estimate is for 2007, when the deduction would be fully in effect and the cost of the deduction would be approximately $6.9 billion.[4] This means that the cost per newly insured person would be about $4,300. For newly insuring a family of four, the government would spend about $17,000.[5]

It should be emphasized that the JCT may not have fully taken into account the possible impact of the deduction on existing employer-based coverage, which could result in some people losing coverage. As a result, the net number of newly insured individuals under the deduction is likely to be less than 1.6 million (see further discussion below).

Deduction Would Do Little to Help the Uninsured

The deduction would provide little subsidy to most workers who currently are uninsured and most workers for whom employers pay too little of the premiums to make insurance affordable. Census data show that at least 93 percent of all uninsured individuals either have incomes too low to incur income tax liability or would pay income taxes at the 10 percent or 15

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[2] Letter from Lindy L. Paull, Staff Director for the Joint Committee on Taxation. to Speaker Dennis Hastert (September 27, 2000).

[3] JCT estimates that 13.1 million taxpayers would take advantage of the tax deduction, of which 800,000 would be previously uninsured, and assumes that two persons are covered by each health insurance policy.

[4] JCT estimate of a deduction identical to that under H.R. 2990 (fully in effect as of 2007) included in the bankruptcy bill passed by the Senate in 2000 (H.R. 833).

[5] JCT estimates that a deduction in 2007 costs $6.9 billion. We estimate the government cost per newly insured individual by dividing the annual cost by the number of newly insured ($6.9 billion / 1.6 million). The Congressional Budget Office has not estimated the number of newly insured individuals under proposals similar to FamilyCare. As a result, no direct comparison is available.

percent marginal rates.[6] These individuals would at most get a subsidy of only 15 percent of the cost of purchasing health insurance.

For those without access to employer-based coverage who must purchase health insurance in the individual market, the "medium" cost of family coverage is $7,400, according to the General Accounting Office.[7] A 15 percent reduction in the premium cost — which would leave the taxpayer to bear the other 85 percent, or nearly $6,300 for the medium policy — would be too small a subsidy to make insurance in the individual market affordable.

- A two-parent family with two children would not receive *any* subsidy from the deduction in 2002 unless its income exceeded $21,050. The family would not have sufficient income to take advantage of the full deduction of a $7,400 medium-cost premium unless its income exceeded $27,200.

- For a couple with two children earning $28,000, the deduction for a $7,400 insurance policy would be worth $740. That would reduce the cost of individual market insurance for the family from 26 percent of income to 24 percent of income. Such a subsidy would not make much difference in making insurance affordable.

- For a similar family in the 15 percent tax bracket earning $40,000, the proposed deduction would reduce the cost of a typical family health insurance policy from 19 percent of income to 16 percent of income (from $7,400 to $6,290). Again, the

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[6] The most recent analysis of census data is from 1998 prior to the significant rate, deduction, and credit changes included in the recently enacted tax legislation.

The 1998 census data found 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 — paid income tax at the 15 percent marginal tax rate (the recent tax legislation carves out a new 10 percent rate within the 15 percent rate). A deduction would provide these taxpayers with a subsidy equal to no more than 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.

These recent tax changes will increase the number of persons who incur no tax liability and the proportion of married taxpayers in the 15 percent tax bracket (the tax legislation carves out a new 10 percent bracket within the 15 percent bracket). As a result, as the tax legislation is fully implemented, the number of uninsured individuals who pay no taxes or pay taxes at the 10 percent or 15 percent rates would exceed 93 percent.

[7] A General Accounting Office study found that in 1998, health insurance premiums for family coverage purchased in the individual, non-group market range from $3,180 to $14,233 per year, depending on factors such as age, health status, and region of the country. The GAO identifies a "medium" premium cost for a family of four as $7,352. U.S. General Accounting Office, *Private Health Insurance: Potential Tax Benefit of a Health Insurance Deduction Proposed in H.R. 2990* (GAO/HEHS-00-104R), April 21, 2000.

subsidy would not be deep enough to make insurance affordable for most such families.

- Few if any low-income families that are unable to purchase health coverage because they cannot afford to spend 26 percent of their income on insurance would now find coverage affordable because a tax deduction had lowered its cost to 24 percent of income. It is also highly unlikely that many moderate-income families would be able to afford health coverage because the cost has fallen by three percentage points to 16 percent of income. It should be noted that to improve participation by those who are eligible, the State Children's Health Insurance Program established in 1997 sets a limit on the premiums and co-payments that states can impose at *five* percent of income for families above 150 percent of the poverty line and smaller amounts for poorer families.

About 15 percent of all uninsured people — or about six million people — live in families where the worker has declined employer-based coverage. Surveys have shown that the most common reason for the uninsured to decline employer-based coverage available to them is that it is too expensive. As a result, the deduction might be of modest help to some moderate-income families whose employer pays half or nearly half of the premium costs, since the deduction would be in addition to the employer subsidy. Yet, even moderate-income families in the 15 percent bracket would receive at most $476 in tax benefits to assist in the purchase of health insurance, assuming $3,175 in the employee share of premium costs (which is half the cost of an average family group insurance policy[8]). The deduction would reduce the proportion of the premium these families must pay only from 50 percent of the premium to 42.5 percent. If the policy had an average cost for a group health insurance policy, the family still would have to pay more than $2,500 a year for insurance. While the modest subsidy these families would receive might help some families afford insurance, the number of such families likely would be small.

Rather than helping currently 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 health insurance. The deduction is worth more than three times as much to individuals in the top tax brackets (as of 2002, the 30 percent, 35 percent, or 38.6 percent brackets) than to lower-income persons in the new 10 percent bracket and more than twice as much than to moderate- and middle-income families in the 15 percent bracket. In general, higher-income taxpayers already can afford insurance without a deduction.

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[8] Kaiser Family Foundation and Health Research Education Trust, *Employer Health Benefits: 2000 Annual Survey* (September 2000); Jon Gabel et al., "Job-Based Health Insurance in 2000: Premiums Rise Sharply While Coverage Grows," Health Affairs (September/October 2000).

Deduction Could Erode Employer-Based Coverage

While few low- and moderate-income uninsured workers would benefit from the deduction, some workers currently with health coverage could be harmed. The deduction could induce some employers currently paying more than 50 percent of premium costs to scale back their contribution to 50 percent or less because employers know that employees have access to the deduction. The availability of the health insurance deduction would also allow small business owners or highly-paid executives 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. One of the leading experts in this area, M.I.T. economist Jonathan Gruber, has estimated the effects of a deduction for the purchase of insurance in the individual market and determined that there would be some dropping of coverage by firms and a number of individuals becoming uninsured as a result of the decrease in employer contributions.[9]

The FamilyCare Proposal

Congress will likely introduce this week bipartisan legislation to expand Medicaid and SCHIP coverage for low-income working parents.[10] A similar proposal drew bipartisan support from a majority of Senators last year.[11]

In 2000, some 34 percent of parents — 6.9 million — in families with incomes below 200 percent of the poverty line ($29,260 for a family of three) were uninsured.[12] This is partly the result of limited coverage under the Medicaid program; the Medicaid income eligibility level for parents is only 66 percent of the poverty line ($9,650 for a family of three).[13] Just as SCHIP facilitated state coverage expansions for low-income children, the FamilyCare legislation would provide additional federal funds (at an enhanced matching rate that is higher than the regular Medicaid matching rate) for states that elect to expand Medicaid and SCHIP coverage to parents

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[9] Jonathan Gruber, "Tax Subsidies for Health Insurance: Evaluating the Costs and Benefits," National Bureau of Economic Research (February 2000).

[10] The lead sponsors in the Senate will be Senators Snowe (R-ME) and Kennedy (D-MA).

[11] A similar FamilyCare bill secured 51 votes in 1999, when offered in the Senate as an amendment to last year's Labor-HHS appropriations bill. For procedural reasons, however, the proposal needed 60 of the possible 100 votes to pass.

[12] CBPP analysis of 2000 Current Population Survey data. The income eligibility levels include income disregards applied by the state.

[13] CBPP survey of highest eligibility thresholds for parents as of July 1, 2000.

of children who are eligible for these programs. Last year, the Health Care Financing Administration estimated that a proposal similar to FamilyCare would provide insurance to about four million uninsured parents.

The FamilyCare proposal would likely also increase coverage of children who are currently eligible for, but not enrolled, in the Medicaid or SCHIP programs. Although nearly 95 percent of uninsured children under 200 percent of the poverty line are now eligible for Medicaid and SCHIP, substantial numbers of eligible children remain uninsured.[14] Research has found that extending health insurance to low-income parents, as FamilyCare would do, boosts coverage of such children. In states that have expanded publicly funded coverage to include working parents, enrollment rates among children are significantly higher.[15]

In addition, in a report issued last year, the President's Council of Economic Advisers determined that providing health insurance directly to low-income families through public programs, as under FamilyCare, is a much more cost-effective way of expanding coverage than a tax deduction.[16] The report found that a tax deduction for health insurance policies would do little to expand coverage.

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[14] Matthew Broaddus and Leighton Ku, *Nearly 95 Percent of Low-Income Uninsured Children Now Are Eligible for Medicaid and SCHIP*, Center on Budget and Policy Priorities (December 2000).

[15] Leighton Ku and Matthew Broaddus, *The Importance of Family-Based Insurance Expansions: New Research Findings about State Health Reforms*, Center on Budget and Policy Priorities (September 2000).

[16] The Council of Economic Advisers, "Reaching the Uninsured: Alternative Approaches to Expanding Health Insurance Access," (September 2000).