



Tax Policy Center
Urban Institute and Brookings Institution

THE TAX POLICY

BRIEFING BOOK

*A Citizens' Guide for the
2008 Election and Beyond*

HEALTH INSURANCE AND HEALTH CARE

| | |
|---|--------|
| How much does the federal government spend? | II-5-1 |
| Who has health insurance coverage? | II-5-2 |
| What tax provisions subsidize the cost of health care?..... | II-5-4 |
| How does the tax exclusion for employer-sponsored health insurance work?..... | II-5-6 |
| How does the employer-sponsored insurance exclusion affect coverage?..... | II-5-8 |

Health Care: How much does the federal government spend?

The administration estimates that the federal government will spend over \$600 billion on health care in fiscal 2008 (see table). Of that, Medicare will claim roughly \$390 billion, Medicaid and the State Children's Health Insurance Program (SCHIP) about \$210 billion, and veterans' medical care about \$34 billion. In addition to these direct outlays, various tax provisions for health create tax expenditures that total roughly \$175 billion; about 85 percent of that figure comes from the exclusion from taxable income of employers' payments for their workers' health insurance premiums.

| Estimated Federal Spending and Tax Expenditures for Health Care, Fiscal 2008 | |
|--|---------------------|
| Program | Millions of Dollars |
| Spending | |
| Medicare | 391,266 |
| Medicaid and SCHIP | 211,353 |
| Veterans' medical care | 33,979 |
| Tax expenditures | |
| Exclusion of employer contributions for medical insurance premiums and medical care | 151,810 |
| Deductibility of medical expenses by individuals | 5,060 |
| Deductibility of charitable contributions to health organizations | 4,890 |
| Self-employed medical insurance premiums | 4,680 |
| Exclusion of interest on hospital construction bonds | 2,950 |
| Medical Savings Accounts and Health Savings Accounts | 1,140 |
| Special Blue Cross and Blue Shield deduction | 640 |
| Tax credit for orphan drug research | 290 |
| Distributions from retirement plans for premiums for health and long-term care insurance | 240 |
| Tax credit for health insurance purchased by certain displaced and retired individuals | 10 |

Sources: Budget of the United States Government Fiscal Year 2009, <http://www.whitehouse.gov/omb/budget/fy2009/budget.html> and Analytical Perspectives, Chapter 19, "Tax Expenditures." <http://www.whitehouse.gov/omb/budget/fy2009/pdf/apers/receipts.pdf>

See Also

Health Care: What tax provisions subsidize the cost?

Health Care: How does the tax exclusion for employer-sponsored health insurance work?

Author: Robertson Williams
Last Updated: April 9, 2008

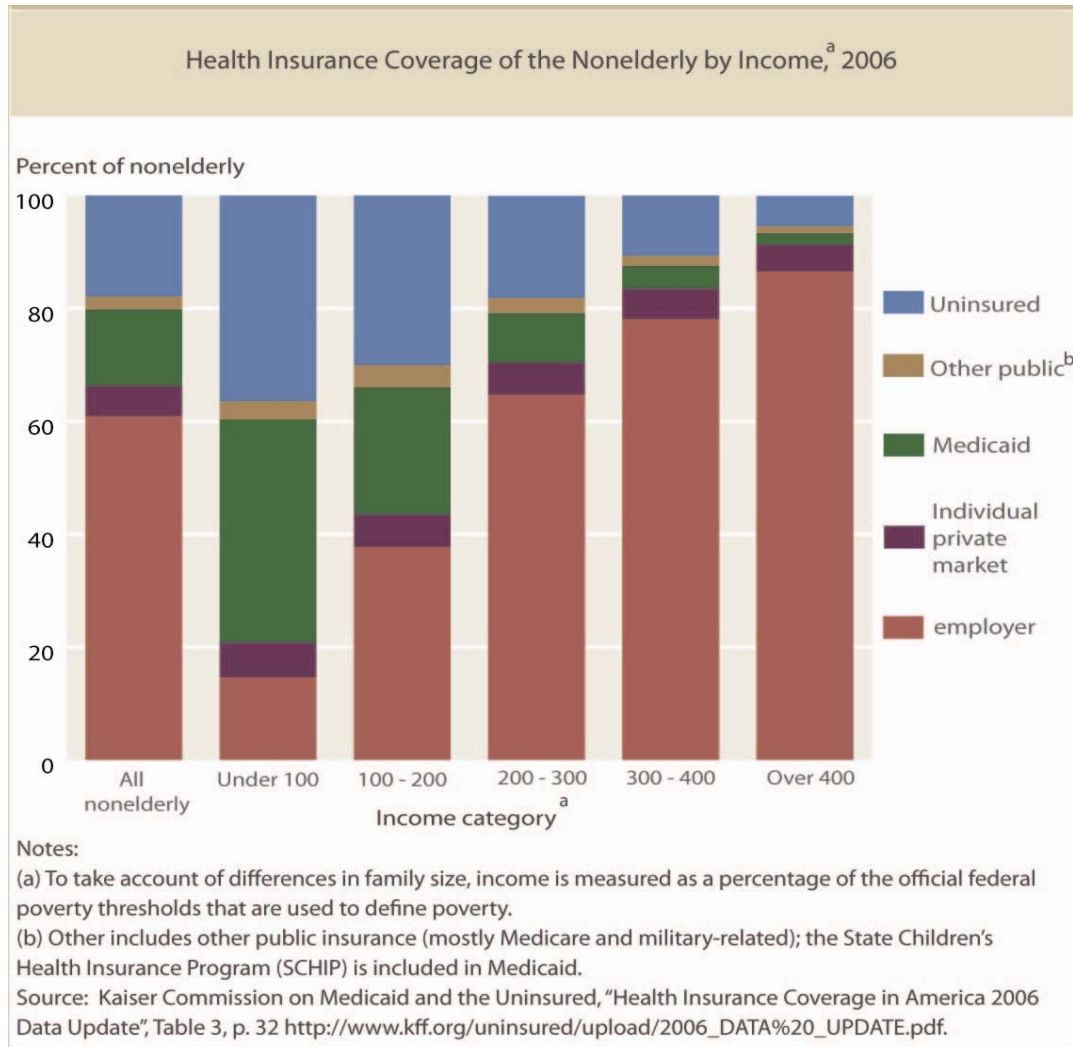
Data Sources

Office of Management and Budget, Budget of the United States Government Fiscal Year 2009.

_____, Budget of the United States Government Fiscal Year 2009, *Analytical Perspectives*, Chapter 19 "Tax Expenditures"

Health Care: Who has health insurance coverage?

More than 60 percent of the nonelderly population in 2006 obtained health insurance coverage through their employer (see left-hand column in figure). About 5 percent purchased coverage on their own in the private insurance market, and about 14 percent were covered by Medicaid. Nearly one-fifth were uninsured. Virtually all elderly individuals participate in Medicare, and those with low income also receive assistance through Medicaid.



- The likelihood that a given individual will be covered by health insurance rises sharply with his or her income (see figure). Only one-fifth of the nonelderly in households with income below the poverty level had private coverage in 2006, and nearly 40 percent reported having no health insurance. In contrast, two-thirds of those in households with income between two and three times the poverty line had private coverage, and 20 percent had no insurance. Over 90 percent of the nonelderly in households with income above four times the poverty level had private coverage, and just 5 percent said they lacked health insurance.

See Also

Health Care: What tax provisions subsidize the cost of health care?

Health Care: How does the tax exclusion for employer-sponsored health insurance work?

Author: Robertson Williams

Last Updated: April 11, 2008

Data Sources

Kaiser Commission on Medicaid and the Uninsured, "Health Insurance Coverage in America 2006 Data Update" (Menlo Park, CA: The Henry J. Kaiser Family Foundation, 2006).

Health Care: What tax provisions subsidize the cost of health care?

Consumers of health care face reduced after-tax costs because a number of tax provisions subsidize either the purchase of health insurance or out-of-pocket medical expenses. Among the provisions generating the largest subsidies are (in descending order of size) the combined employer exclusion and employee deduction for employee health insurance premiums, the exclusion for Medicare and Medicaid coverage and benefits, the individual deduction for health insurance and expenses, the deduction for Health Savings Accounts, the deduction of insurance premiums for the self-employed, the deduction of premiums and benefits for the military, and the deduction for Flexible Spending Accounts.

- Employer contributions to pay premiums for employee health insurance are not subject to income or payroll tax. In addition, employee contributions are often deducted from income before tax is withheld, so that employees pay no tax on the income they use to pay premiums for employer-sponsored health insurance. Estimated revenue cost in 2008: \$116.5 billion (all estimates from the congressional Joint Committee on Taxation).
- Health insurance coverage under Medicare or Medicaid is excluded from taxable income. Benefits paid from either program are similarly exempt from taxation. Estimated revenue cost in fiscal 2008: \$42.8 billion.
- Individuals may claim as an itemized deduction the portion of their health insurance premiums and other medical expenses that exceeds 7.5 percent of their adjusted gross income. Estimated revenue cost in fiscal 2008: \$9.5 billion.
- Individuals under 65 who are covered by a high-deductible health insurance plan, whether through their employer or through the nongroup market, may contribute to a Health Savings Account. The 2008 contribution limits are \$2,900 for individuals with self-only coverage and \$5,800 for individuals with family coverage. Individuals age 55 and older may make additional contributions of up to \$900. Individual contributions are deductible from taxable income. Employer contributions (up to the limit minus any employee contribution) are not subject to income or payroll tax. Withdrawals from Health Savings Accounts for medical expenses are not subject to income tax. Estimated revenue cost in fiscal 2008: \$8.1 billion.
- Self-employed individuals may deduct from their income the entire cost of health insurance for themselves, their spouses, and their dependents (subject to certain conditions). Estimated revenue cost in fiscal 2008: \$4.4 billion.
- Health insurance coverage and benefits for current and retired members of the military and their dependents are excluded from taxable income. Estimated revenue cost in fiscal 2008: \$3.3 billion.
- Individuals whose employers offer Flexible Spending Accounts may set aside funds from their pay each year to cover health insurance premiums and most medical expenses. Employers set maximum funding levels with no legislated limit. Contributions are not subject to income or payroll taxes. Participants must set the level of their contributions before the beginning of the benefit year and forfeit any funds not used to pay for qualified medical expenses during the year. Estimated revenue cost in fiscal 2008: not available.

See Also

Health Care: How does the tax exclusion for employer-sponsored insurance work?

Data Sources

U.S. Congress, Joint Committee on Taxation, "Estimates of Federal Tax Expenditures for Fiscal Years 2007-2011" (Washington: September 2007).

Authors: Austin Nichols and Carol Rosenberg
Last Updated: March 13, 2008

Further Reading

Burman, Leonard E., "Tax Code and Health Insurance Coverage: Before the House Committee on the Budget" (Washington: Tax Policy Center: October 2007).

Congressional Budget Office, "The Tax Treatment of Employment-Based Health Insurance" (Washington: March 1994).

_____, "Testimony on the Tax Treatment of Employment-Based Health Insurance" (Washington: April 26, 1994).

Lyke, Bob, "Tax Benefits for Health Insurance and Expenses: Current Legislation" (Washington: Congressional Research Service, February 2005)

Health Care: How does the tax exclusion for employer-sponsored health insurance work?

Employers' payments covering premiums for employer-sponsored health insurance are exempt from federal income and payroll taxes. Any portion of premiums paid by the employee is typically excluded from taxable income and is therefore also tax-free, although some employers require employees to pay their share of premiums out of after-tax income. The exclusion of premiums lowers most workers' tax bills and thus reduces their after-tax cost of health insurance coverage. This effective tax subsidy is a major reason why most Americans have health insurance coverage through either their own employer or that of a family member. Other factors also play a role, however, including the lower costs of group coverage and reduced administrative expenses.

- Some employers provide only access to group insurance and do not help pay premiums. Even in such cases, however, the premiums that workers pay are typically exempt from income tax.
- Because the exclusion of premiums for employer-sponsored insurance reduces taxable income, it is worth more to taxpayers in higher income tax brackets than to those in lower brackets. Consider a worker in the 15 percent bracket who also (in effect) pays a combined (employer and employee) payroll tax of 15.3 percent. If his insurance premium is \$1,000, his taxes fall by \$303, that is, 30.3 percent (15 percent + 15.3 percent) of \$1,000. His after-tax cost of health insurance is thus \$1,000 less \$303, or \$697. In contrast, a worker in the 25 percent bracket faces a total tax rate of 40.3 percent (25 percent + 15.3 percent). For her, the after-tax cost of a \$1,000 premium is just \$597 (\$1,000 minus 40.3 percent of \$1,000). Savings on state and local taxes could further lower the cost for both workers.
- For low-income workers who face a negative tax rate because of the earned income tax credit (EITC), the exclusion actually raises the after-tax cost of health insurance. For example, a worker with two children and earnings of \$12,000 faces a net tax rate of -24.7 percent (her negative 40 percent rate due to the EITC plus the 15.3 percent payroll tax rate). If the worker excludes \$1,000 paid to cover her health insurance premium, her after-tax income (before paying for health insurance) falls by \$247, because she loses \$400 of EITC, which is only partially offset by her savings of \$153 in payroll taxes. In effect, her cost for health insurance is \$1,247.
- Replacing the tax deduction for health insurance with a tax credit would equalize the tax benefits across taxpayers in different tax brackets, as well as between those who get insurance through their employers and those who obtain coverage from other sources. Making the credit refundable would extend that benefit to those whose tax liability falls below the value of the credit.

See Also

Health Care: What tax provisions subsidize the cost of health care?

Health Care: How does the employer-sponsored insurance exclusion affect health insurance coverage?

Authors: Austin Nichols and Carol Rosenberg

Last Updated: March 13, 2008

Further Reading

Burman, Leonard E., Jason Furman, Greg Leiserson, and Roberton Williams, "The President's Proposed Standard Deduction for Health Insurance: An Evaluation" (Washington: Tax Policy Center, February 15, 2007).

Health Care: How does the employer-sponsored insurance exclusion affect coverage?

The exclusion of employer-sponsored insurance (ESI) from taxable income tends to increase coverage rates because it lowers the cost of insurance for most people, spurring demand. Its effects are uneven, however, and alternative policies that focus subsidies more broadly and on those less likely to get insurance on their own could have greater impact at the same cost. Because the cost reduction increases with the individual’s marginal tax rate, the ESI exclusion gives smaller benefits to lower-income workers than to those with higher incomes, who are already more likely to obtain insurance coverage. In contrast, a refundable tax credit available to everyone would provide the same subsidy for all insured workers as well as nonworkers, and thus would not exacerbate already unequal coverage rates. Shifting to such a policy could increase coverage without raising costs.

- About 83 percent of all workers are offered health insurance by their employers, and roughly two-thirds of those workers accept the offer (see table).

| Workers and Dependents with Employer-Sponsored Health Insurance Coverage by Marginal Effective Income Tax Rate, 2007 | | | | |
|--|----------------------------------|---------------------------|-------------------------------------|----------------------------------|
| Marginal Effective Income Tax Rate | Millions of Workers ^a | Percentage with ESI Offer | Share Receiving ESI ^b | |
| | | | Percentage with ESI as Policyholder | Percentage with ESI as Dependent |
| Single | | | | |
| 0 or negative | 7.55 | 65.9% | 22.4% | 9.0% |
| Up to 10 percent | 4.59 | 72.3% | 35.2% | 5.5% |
| Up to 15 percent | 13.73 | 86.8% | 65.8% | 2.7% |
| Up to 25 percent | 9.50 | 91.1% | 77.2% | 1.6% |
| Up to 28 percent | 2.40 | 96.0% | 85.2% | 1.0% |
| Up to 33 percent | 0.66 | 91.6% | 74.1% | 2.8% |
| Up to 35 percent | 0.25 | 90.1% | 71.6% | 3.8% |
| Over 35 percent | 0.25 | 92.4% | 68.8% | 3.8% |
| All | 38.92 | 82.8% | 57.9% | 3.9% |
| Married/Head of Household | | | | |
| 0 or negative | 12.11 | 67.9% | 35.8% | 10.1% |
| Up to 10 percent | 8.55 | 75.9% | 46.6% | 10.0% |
| Up to 15 percent | 25.89 | 86.1% | 61.7% | 22.8% |
| Up to 25 percent | 22.84 | 86.5% | 62.3% | 23.7% |
| Up to 28 percent | 9.41 | 85.9% | 61.7% | 23.7% |
| Up to 33 percent | 9.65 | 86.7% | 61.2% | 23.6% |
| Up to 35 percent | 1.76 | 86.9% | 63.1% | 28.0% |
| Over 35 percent | 2.30 | 85.6% | 61.9% | 23.1% |
| All | 92.52 | 82.9% | 57.0% | 20.4% |

Source: Tax Policy Center Microsimulation Model.

a. Includes only workers aged 19 to 64 employed in the private sector, by the federal government, or by state and local governments.

b. Share of all workers, not just of those offered ESI.

- Workers facing the lowest marginal tax rates are much less likely to be offered insurance coverage than those facing higher rates. Only about 70 percent of workers with marginal tax

rates of 10 percent or lower receive such offers, compared with more than 85 percent of those with tax rates above 10 percent.

- Take-up rates for single workers first rise and then fall as the marginal tax rate rises. About one-fifth of all single workers with the lowest tax rates receive and accept an offer of ESI, rising to about five-sixths of those with tax rates around 28 percent. But only about two-thirds of those facing the top marginal rate are offered and accept coverage. In contrast, about three-fifths of married and head-of-household workers across all but the two lowest tax categories in the table do so.
- Married or head-of-household workers are much more likely than their single counterparts to get health insurance by virtue of being dependents of other workers, although those who face lower tax rates are less than half as likely to do so as those facing higher rates. More than half of married and head-of-household workers who face marginal tax rates above 10 percent and who do not get insurance from their own employers receive coverage as dependents.
- Many factors besides cost affect whether people obtain health insurance coverage. Low-income individuals, especially younger ones, may face lower health risk and thus perceive less need for coverage. They may choose to spend their scarce resources on other goods and thus have lower willingness to pay for insurance. They may also find it easier than others to satisfy income and asset eligibility requirements for public coverage in the event of a serious health condition. These factors make it difficult to know whether low-income individuals would elect to purchase health insurance even if they faced the same price as higher-income individuals.
- Many proposals to expand health insurance coverage focus on increasing tax incentives to obtain health insurance. Yet a 2004 study examined a range of tax policies designed to increase coverage and found that every one was much less efficient at increasing coverage than expansions of public insurance. The study did find, however, that policies tightly targeted to the lowest income earners were much more efficient at increasing coverage than those that are also available to households higher in the income distribution.

•

See Also

Health Care: How does the tax exclusion for employer-sponsored health insurance work?

Health Care: What tax provisions subsidize the cost of health care?

Authors: Austin Nichols and Surachai Khittarakun

Last Updated: April 9, 2008

Further Reading

Burman, Leonard E., and Jonathan Gruber, "Tax Credits for Health Insurance," Tax Policy Center Issues and Options Brief 11 (Washington: The Urban Institute, 2005).

_____, "Tax Credits for Health Insurance," Tax Policy Center Discussion Paper 19 (Washington: The Urban Institute, 2005).

Burman, Leonard E., Cori E. Uccello, Laura Wheaton, and Deborah Kobes, "Tax Incentives for Health Insurance," Tax Policy Center Discussion Paper 12 (Washington.: The Urban Institute, 2003).

Gruber, Jonathan, "Tax Policy for Health Insurance," NBER Working Paper 10977 (Cambridge, Mass.: National Bureau for Economic Research, 2004).