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HEALTH BILL GIVES BIGGER SUBSIDIES TO NEWLY COVERED HEALTH EXCHANGE USERS THAN TO PEOPLE WHO GET INSURANCE AT WORK

The House, Senate, and Administration health care bills all offer large subsidies for low income and middle income individuals and households to purchase health insurance. The policies will be offered through a government supervised "health insurance exchange," a sort of farmers' market for individual and family policies provided by private insurers. About 127.3 million people under Medicare age (age 65) with incomes between 100% and 400% of the poverty level might be eligible.[1]

The Congressional Budget Office estimates that a far smaller number, about 19 million people, will use the new exchange to purchase individual and family policies, with the rest getting insurance at work or through other means, or remaining without coverage. People who already obtain health insurance at work from employer-provided health insurance plans will generally not be eligible to buy the exchange-based plans, and a business would be fined if too many of its employees switch to the government-subsidized program.

Employer-based health insurance is a tax-favored fringe benefit. The employee is taking part of his or her income "in kind" instead of in cash, and the in-kind benefit is not counted as taxable income of the employee. Neither income tax nor payroll tax is imposed on the value of the insurance premium. The employee is receiving an implicit tax subsidy equal to his or her marginal income tax rate plus the payroll tax rate.

The health bill subsidies for people eligible to buy the new health exchange policies would be much larger than the tax subsidies currently available to people with employer-provided health insurance. Making people remain with their employment-based plans, instead of switching to the new subsidy program, will hold down the cost of the new program for the government. However, it will mean that two otherwise identical households with the same total income, number of adults, and number of children would face sharply different costs of insurance and health care. This is a violation of the tax principle of horizontal equity, which requires that people with equal incomes and family circumstances pay equal taxes. It also strains the concept of equal treatment under the law.

Subsidies in the House-passed bill

The Congressional Budget Office (CBO) has presented illustrative tables showing the cost to participants of a typical health plan under the House bill and the Senate bill. The House bill numbers are shown in the table. The cost would be held down the most for lowest income households (those at the poverty level), and would rise as income increases until the subsidy is ended entirely for households at 400 percent of the poverty level. There would be subsidies for the premium, and there would also be subsidies for the out-of-pocket costs, such as deductibles and co-payments. All incomes and prices are in 2016 dollars. The House health bill numbers are derived from the CBO tables. The tax subsidy numbers for the employer-provided plan are calculated by the author.

A family of four earning $42,000 (1.75 times the projected poverty level in 2016) would be charged only $1,900 for their health plan, which has a full cost of $15,000. That's a federal subsidy of $13,100, or 87% of the cost of the plan. A worker with a similar total income consisting of cash wages plus an employer-provided insurance plan would receive the employer provided plan tax free. He and the employer would not owe payroll or income tax on the plan. The combined weighted tax rate from these two taxes would be 23.8%. (The family's premium, if taxable, would fall partly into the 0% and the 10% income tax brackets, and the payroll tax rate is 15.3%). That is the percent of the plan cost that the current tax break would save. The dollar savings would be $3,574. That is $9,526 less than people covered by the new subsidy would receive.

The House bill would also provide a subsidy for the family's cost sharing. The CBO estimates that the average cost sharing (deductibles and copayments) would equal $5,500. The bill would limit the family's cost to $1,200. That's a subsidy of $4,300, or 78% of the cost sharing. There would be no income or payroll tax on the subsidy.

By contrast, a family with an employer-provided health insurance plan can only get an income tax break on its cost-sharing, and only under limited circumstances. The out-of-pocket cost must be reported as an itemized medical deduction on the income tax. (There is no tax relief if the taxpayer takes the standard deduction.) The medical cost must exceed 7.5% of adjusted gross income before any deduction is allowed. Only the excess over 7.5% of income is deductible, and the family would save an amount equal to the deduction times its marginal income tax rate of 10%. In this example, assuming the family incurs the average expected cost sharing, the tax break would be $384, covering 6.3% of its out-of-pocket costs.

Adding the two subsidies together for the premium and the cost sharing, we find that the family getting the health exchange policy has a total subsidy of $17,400, or 85%. The family getting its policy through its employer has a total subsidy of $3,921 or 19.1%. That's a difference of $13,479. The differentials drop to about $9,800 for the $52,000 family and $2,000 for the $78,000 family. Such differentials would create incentives for people to abandon employer-provided plans in favor of the health exchange policies. That incentive to switch may mean that the CBO is under-estimating the number of health exchange participants and the cost of the subsidies.

CBO notes that the lowest income family in the table might be eligible for Medicaid in most states after the health bills ease the eligibility requirements, and would be placed on that program. It would then get nearly 100% of its health costs covered.

The earned income tax credit could affect the results for some families. Families getting part of their income as a tax exempt employer-provided health plan have lower cash income and lower adjusted gross income for tax purposes. A family with a lower AGI retains more of its EITC, which is phased out as incomes rise, than a family with all cash income. That effect (not shown) would not matter for the lowest income family on Medicaid, or for the top five families in the table for whom the credit is fully phased-out. However, for the $42,000 family, it could reduce the difference between the health bill and tax subsidies to a bit under $10,000 if the family has two children (with less of reduction for couples with no children or one child). That would reduce but not eliminate the incentive to cash out their employer-provided plan and switch to the health exchange system.

The House health bill subsidies fall as a family's income rises. Meanwhile, the value of the tax exclusion for employer-provided health plans rises with income, because marginal income tax rates rise with income. The tax subsidy begins to exceed the

Subsidies in the House Health Bill Compared to Employer-Provided Insurance
"Silver Plan" policy premium for a married couple with two children
Assumes premium cost of $15,000 with average cost sharing of $5,500

	House Health Bill Subsidy			**Tax Subsidy for Employer Plans**		**Difference**
	Premium subsidy for plan costing $15,000					
Income (AGI)	Payment	Subsidy	Percent Subsidy	Tax	Percent Subsidy	
$30,000	$500	$14,500	96.7%	$2,374	15.8%	$12,126
$42,000	$1,900	$13,100	87.3%	$3,574	23.8%	$9,526
$54,000	$3,900	$11,100	74.0%	$4,110	27.4%	$6,990
$66,000	$6,300	$8,700	58.0%	$4,545	30.3%	$4,155
$78,000	$8,800	$6,200	41.3%	$4,545	30.3%	$1,655
$90,100	$11,100	$3,900	26.0%	$4,545	30.3%	-$645
$102,100	$15,000	$0	0.0%	$4,545	30.3%	-$4,545
	Cost sharing subsidy for average cost sharing of $5,500					
Income (AGI)	Payment	Subsidy	Percent Subsidy	Tax Subsidy	Percent Subsidy	
$30,000	$600	$4,900	89.1%	$438	8.0%	$4,463
$42,000	$1,200	$4,300	78.2%	$348	6.3%	$3,953
$54,000	$2,300	$3,200	58.2%	$386	7.0%	$2,814
$66,000	$3,700	$1,800	32.7%	$251	4.6%	$1,549
$78,000	$5,000	$500	9.1%	$116	2.1%	$384
$90,100	$5,500	$0	0.0%	$0	0.0%	$0
$102,100	$5,500	$0	0.0%	$0	0.0%	$0
	Combined subsidy for premium plus average cost sharing totaling $20,500					
Income (AGI)	Payment	Subsidy	Percent Subsidy	Tax Subsidy	Percent Subsidy	
$30,000	$1,100	$19,400	94.6%	$2,811	13.7%	$16,589
$42,000	$3,100	$17,400	84.9%	$3,921	19.1%	$13,479
$54,000	$6,200	$14,300	69.8%	$4,497	21.9%	$9,803
$66,000	$10,000	$10,500	51.2%	$4,796	23.4%	$5,704
$78,000	$13,800	$6,700	32.7%	$4,661	22.7%	$2,039
$ 90,100	$16,600	$3,900	19.0%	$4,545	22.2%	-$645
$102,100	$20,500	$0	0.0%	$4,545	22.2%	-$4,545

health bill subsidy at about $85,000 in income (about $10,000 higher in the Senate bill). At lower income levels, the very generous subsidies in the House health bill outstrip the tax break on employer-provided plans. For that reason, the bill places restrictions on people trying to switch from employer plans to the health exchange programs. With such large differences in subsidies, however, people are bound to find ways to switch over, even if it means changing jobs, eliminating employer plans, or contracting out low wage activities such as cleaning services instead of doing them in-house. These large differences in subsidy levels probably mean that the official cost estimate for the bill is unrealistically low.

The Senate premium subsidies are very similar to the House levels. They are slightly less generous for the first four families shown in the table, and slightly more generous for the last three. The Senate cost sharing subsidies are less generous and apply only to the first two families. The others may (rarely) claim a medical deduction, like families that have employer-provided plans. In both bills, the percentage premium subsidies for single taxpayers are close to those for joint filers at the lowest income levels, but fall off more rapidly as incomes rise relative to the poverty level. They are still about two to four times more generous for the second through the fourth ranked families than the corresponding tax subsidies for employer-provided plans.

The subsidies in the House and Senate health bills are extreme. They vary enormously across households with similar incomes, violating horizontal equity. They have odd results in which younger, poorer families will be subsidizing older, richer households, violating vertical equity. As noted in another IRET study,[2] the loss of the subsidy as earnings rise, combined with the taxes on the higher incomes, would result in very high effective marginal tax rates that would punish people for working harder, accepting promotions, and obtaining the training necessary to get a better job. There would be little net benefit from earning more money, reminiscent of the "poverty traps" that existed in high tax/high benefit states in the 1970s and 1980s before major welfare reforms. The country would be well-served if these bills were scrapped, and the health reform effort were sent back to the drawing board.

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Endnotes

1. Source: U.S. Census Bureau, Current Population Survey, 2009 Annual Social and Economic Supplement, accessed at http://www.census.gov/hhes/www/cpstables/032009/pov/new01_100_01.htm.

2. Michael Schuyler, "Health Bills’ Tax Increases Would Harm Health Care And The Economy," *IRET Congressional Advisory*, No. 260, December 11, 2009, available at http://iret.org/pub/ADVS-260.PDF.