Joint Economic Committee Democrats

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Administration's Health Insurance Proposals: A Boon to the Healthy and Wealthy but No Help for the Uninsured

The Administration's FY 2007 Budget includes several tax initiatives to promote and expand the use of health savings accounts (HSAs) and high-deductible health insurance. Rather than addressing the serious issues of health insurance access and affordability that most families confront, the Administration's proposals would largely benefit healthy and economically secure families.

Taken together, the proposals would weaken employer-sponsored health insurance coverage, likely *increase* the number of uninsured, do little to contain rising health care costs, and make HSAs a more attractive tax shelter for high-income families. The Treasury Department estimates that the proposals would reduce federal revenues by over \$156 billion in the next ten years. The costs would be substantially higher over the longer-term.

Background: Health Savings Accounts and High-Deductible Health Insurance.

The Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (P.L. 108-173) established health savings accounts—tax-advantaged accounts for health care spending. Only people with qualified high-deductible health insurance coverage can contribute to an HSA. In 2006, a qualifying high-deductible plan must have an annual deductible of at least \$2,100 for family coverage and at least \$1,050 for self-only coverage, and limit out-of-pocket expenses to \$10,500 for families and \$5,250 for singles. Access is generally limited to those under age 65. Anyone enrolled in Medicare cannot contribute to an HSA.

Contributions made by employers to an employee's HSA are excluded from gross income and thus escape income and payroll taxes. Household contributions to an HSA are deductible when computing income taxes, even if taxpayers do not itemize deductions on their tax returns (an "above-the-line" deduction). Contributions can remain in the account from one year to the next until withdrawn. Earnings on amounts in the accounts accumulate tax-free. Withdrawals are also tax-free, if used to pay for qualified medical expenses. Withdrawals for other purposes are fully taxable and, if the account holder is under age 65, subject to an additional 10 percent penalty.

A participant with self-only high-deductible insurance coverage can make an annual tax- deductible contribution of up to \$2,700 to an HSA, but in no case more than the amount of the annual health plan deductible. A participant with family coverage can make a tax- deductible contribution of up to \$5,450, but again, no more than the amount of the insurance plan deductible.

The President's Proposal

The Administration's Budget proposals aim to encourage the use of high-deductible insurance plans and HSAs by (1) subsidizing premiums for high-deductible insurance purchased in the non-group market, and (2) increasing the tax subsidies for HSA contributions.

Subsidized premiums for high-deductible health insurance. The Administration has proposed two options for subsidizing premiums for high-deductible health insurance. These tax subsidies would apply only to insurance purchased in the non-group market. Those covered by private employer-sponsored plans, Medicare, Medicaid, or other government-provided health insurance would not be eligible.[1]

- The first option is an above-the-line tax deduction for high-deductible health insurance premiums together with a refundable tax credit for 15.3 percent of those premiums (subject to a limit of 15.3 percent of earnings subject to employment taxes).

- The second option is a refundable tax credit for low- and moderate-income families of up to 90 percent of high-deductible health insurance premiums. The credit would be limited to $500 per child and $1,000 per adult (up to $3,000 per family), and would phase out for families with income between $25,000 and $60,000, and for individuals with income between $15,000 and $30,000.

Households could claim either option but not both.

The first option is an attempt to equalize the tax treatment of employer-sponsored insurance and insurance purchased in the non-group market. Currently, employer-paid health insurance premiums are not counted as income for purposes of income or payroll taxes. Individuals purchasing insurance in the non-group market do not receive the same tax subsidies. An above-the-line income tax deduction together with a refundable credit for payroll taxes would provide the same tax treatment to insurance purchased in the non-group market as employer-paid premiums.

An income tax deduction for health insurance premiums is much less valuable to low- and moderate-income households because they face low marginal income tax rates. The second option would, therefore allow such households to claim a more generous refundable credit in place of the tax-deduction and the 15.3 percent credit.

Increased tax subsidies for HSAs. The Administration would increase the limit on tax-deductible contributions to an HSA to the maximum out-of-pocket expenses for an eligible high-deductible health insurance plan—currently $5,250 for an individual and $10,500 for a family.

The Administration would also allow households to claim a refundable income tax credit of 15.3 percent of their HSA contributions (but not more than 15.3 percent of earnings subject to employment taxes) in addition to the income tax deduction. The new credit is meant to equalize the treatment of employer and employee contributions, by providing a tax credit to offset the payroll tax on earnings. The penalty for withdrawals for non-medical expenses would increase to 30 percent for account holders under age 65 and to 15 percent for those age 65 or older to recapture the additional tax credit.

Likely to Increase the Number of Uninsured

The Administration's proposal would remove the tax-advantage for employer-sponsored health insurance relative to coverage purchased in the individual non-group market. Some small businesses may choose to drop coverage entirely if there is no longer a tax advantage to employer-sponsored coverage, forcing workers to purchase insurance in the high-cost non-group market.

A recent report by MIT economist Jonathan Gruber suggests that the number of uninsured would actually increase if all of the Administration's proposals were adopted. Professor Gruber estimates that the new tax incentives would result in 3.8 million previously uninsured people obtaining coverage through a high-deductible health plan. However, because some employers are likely to drop coverage, about 8.9 million previously insured workers will lose employer-sponsored coverage. Of those, about 3.7 million would find coverage in the costlier and riskier non-group market while about 4.0 million previously covered workers would become uninsured. The net impact would be an increase in the number of uninsured by 600,000.[2]

Could Undermine Traditional Insurance

By increasing the incentives for people to choose high-deductible plans over traditional plans, additional tax incentives for high-deductible policies could undermine traditional insurance. As healthier individuals leave traditional plans, those remaining in the plans will be those who are more expensive to insure. Insurers will have to raise premiums to cover their expenses, driving more people into high-deductible plans. In the extreme, such a vicious cycle could result in a market in which high-deductible plans are the only real option.

Being forced into a high-deductible insurance plan would increase the out-of-pocket health care costs of families whose medical costs are already greater than their deductible in a traditional plan. Meeting a minimum deductible of $2,100 or more would be a particular burden for lower-income families.

Health Insurance Would Remain Unaffordable

Most uninsured lack coverage because it is not affordable. The uninsured predominantly are from working families with low or moderate incomes who do not have access to health insurance coverage through their employers, and who face high premiums in the non-group market. In 2004, one-third of the uninsured were from households with income under $25,000, and almost two-thirds were from households with income under $50,000 (**Table**).

The low-income refundable health coverage tax credit would not be nearly generous enough for most low-income uninsured to afford coverage. The price of insurance in the non-employer group market is prohibitively expensive for most uninsured, with typical family plan premiums of over $12,000. A $3,000 tax credit will still not make insurance coverage affordable.

The Administration also believes that raising the cap on contributions to an HSA account will make high-deductible plans more attractive to the uninsured and those looking for an alternative to traditional insurance plans. But most low-income uninsured cannot even afford premiums, and would be unlikely to contribute to an HSA account at current or increased levels.

A Costly Tax Subsidy for the Healthy and Wealthy

The Treasury Department estimates that the total cost of the Administration's proposals would be approximately $156 billion over 10 years. Because revenue losses grow over time as funds accumulate in the accounts, the costs beyond the 10-year budget window will be even higher.

The Administration's proposal provides costly tax subsidies for those who can already afford to pay higher out-of-pocket costs—generally the wealthy and healthy. The increase in the contribution limits for HSA accounts will cost $90 billion, while an above-the-line deduction for high-deductible insurance premiums paid by certain HSA participants would result in $41.3 billion in lost revenues over ten years.[3] The tax credit for low-income Americans to purchase health insurance would cost over $24 billion over the first ten years. Thus, only about 15 percent of the cost of the proposal would subsidize health insurance coverage for low-income households.

People Without Health Insurance for All of 2004

Household Income	Number of Uninsured (thousands)	Percentage of the Uninsured
Less than $25,000	15,102	33
$25,000 to $49,999	14,784	32
$50,000 to $74,999	7,842	17
$75,000 or more	8,092	18
Total	45,820	100

Source: U.S. Census Bureau, *Income, Poverty, and Health Insurance Coverage in the United States: 2004,* Table 7.

The tax subsidy for high-income families is substantial. Each dollar contributed to an HSA saves up to 35 cents in taxes—more if state and local income taxes apply. For example, a high-income family with a combined federal and state tax rate of 40 percent would save $2,000 in taxes if it contributed $5,000 to an HSA. Earnings on amounts carried over from year to year are tax free, as are withdrawals used to pay for qualified medical expenses. Raising the amount eligible to contribute to HSAs would drastically increase the savings potential. That same family could save $10,000 and receive $4,000 in tax savings.

The combination of tax-deductible contributions, tax-free earnings, and tax-free withdrawals is unique to HSAs. Other tax-advantaged saving accounts such as traditional IRAs, Roth IRAs, or 401(k) type plans allow either tax-deductible contributions or tax-free withdrawals, but not both. Contributions to those accounts do not qualify for an additional 15.3 percent tax credit to offset employment taxes. Flexible spending arrangements allow tax-deductible contributions and tax-free withdrawals, but funds in flexible spending accounts cannot carry over from year to year and do not accumulate tax-free earnings.

Ordinary families will have little chance to benefit from the tax advantages of carrying over funds from one year to the next after meeting the expenses of out-of-pocket health care costs. There will be little remaining of annual HSA contributions once families withdraw funds to pay for health care expenses up to the higher insurance deductible required to have an HSA, other insurance co-payments, and the cost of non-covered medical expenses.

Little Impact on Health Care Spending

Additional tax incentives for high-deductible health insurance and HSAs are part of the Administration's push for "consumer-driven" health care, a term used to describe insurance plans and health care reforms in which families have more financial responsibility and greater control over their health care spending.

Consumer-driven health care, in its simplest form, would shift more health care costs to the individual, forcing consumers to make more choices about the quantity and quality of medical care they use. Proponents believe that it is possible to contain health care spending by making consumers more selective and cost-conscious shoppers for health care. There are a number of reasons, however, why these plans are unlikely to limit spending.

First, while higher deductibles may provide an inducement to reduce spending on covered expenses up to the deductible limit, HSAs create an incentive to increase spending on medical expenses and procedures that health insurance plans typically do not cover. Health savings accounts in effect provide up to a 35 percent federal subsidy—the family's marginal income tax rate—for these uncovered medical expenses.

Second, a significant portion of health care spending is for major and costly procedures that exceed the deductible limits required in the law.[4] High-deductible policies would not have any effect on spending in excess of the deductibles.

Finally, by requiring consumers to pay for medical expenses up to the high-deductible amount, high-deductible insurance discourages lower-income individuals and families from receiving preventive care that could prevent illness or diseases in the future. Existing rules for health savings accounts permit qualifying high-deductible plans to waive the deductible for preventive care, but plans are not required to have this feature. There is little evidence to suggest that people successfully differentiate between necessary and unnecessary procedures when choosing how to spend their health care dollars.

Sophisticated proponents of consumer-driven care recognize that for these plans to succeed there will need to be a massive effort to educate consumers about medical care choices including ratings of providers and procedures. They also recognize that there will need to be special provisions for chronically ill and low-income patients. The Administration's proposals do not address either of these critical issues.

Conclusion

The lack of health insurance coverage for more than 45 million Americans and inadequate coverage for millions more is a serious concern, as is the rising cost of health care. Real health care reform should be structured in a way that lowers costs, increases access (especially for the uninsured), and improves the quality of coverage. Tax incentives for the purchase of high-deductible health insurance in the individual non-group market and additional tax subsidies for contributions to health savings accounts would cost billions in lost tax revenues and fail to accomplish these goals.

Endnotes

[1] Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2007 Revenue Proposals, February 2006*, pp.21-27.
[2] CBPP's analysis shows that the non-targeted tax deductions and credits would be the biggest contributor to the rise in the uninsured. While the low-income tax credit would increase insurance coverage by 1.4 million, the combination of all the Administration proposals would result in a rise in the uninsured population. See Jonathan Gruber, "The Cost and Coverage Impact of the President's Health Insurance Budget Proposals," Center on Budget and Policy Priorities, February 15, 2006.
[3] Department of the Treasury, "General Explanations of the Administration's Fiscal Year 2007 Revenue Proposals," February 2006, p. 27.
[4] Economists from the Urban-Brookings Tax Policy Center found that close to 80 percent of medical expenditures by insured working families exceeded the HSA-required deductibles. See Linda Blumberg and Leonard E. Burman, "Most Households' Medical Expenses Exceed HSA Deductibles," *Tax Notes*, August 16, 2004, p. 759.

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