



# The Council for Affordable Health Insurance's ISSUES & ANSWERS

Solutions for Today's Health Policy Challenges

No. 102

April 2002

## *No Justice, No Insurance*

There is a reason nearly 40 million Americans lack health insurance: tax discrimination. Until the federal government redresses that discrimination, millions of Americans, especially low-income workers, will remain uninsured with little or no access to affordable health insurance.

**A Legacy of Tax Discrimination.** The current tax treatment of health benefits is the primary factor behind the growing number of uninsured, because federal law provides a significant tax break for those who get their health insurance through an employer and for the self-employed.

Today's health care system is in large measure the direct result of tax policies put into effect during World War II. Wage and price controls implemented at that time made it difficult for employers to attract the best workers. In response, many employers started offering health insurance as part of the compensation package. That coverage was quite different from what most employees expect today. Health insurance was largely hospital insurance, covering workers and their families if they experienced a major accident or illness. Individuals paid most of their small and routine health care expenses out of pocket.

Shortly after the war, Congress passed legislation that allowed employers to take tax deductions for employee health insurance and enabled employees to receive it tax free (i.e., a "tax exclusion," which means money spent on the

benefit is excluded from employee income).

The favorable tax treatment of employer-financed health care led to an employer-based health care system. Currently, about 90 percent of those under the age of 65 who have insurance get it through an employer.

In addition to providing a tax break for employer-provided health insurance, Congress allows the self-employed to deduct 70 percent of the cost of a health insurance policy, rising to 100 percent by 2003, assuming Congress makes no other changes.

But those who work for employers who don't provide health insurance get no tax help. They must pay their taxes first and buy a policy with what's left over.

Thus the tax law unjustly favors one type of worker and employer over another. This policy distorts the job market by discouraging employees from changing jobs for fear of losing their coverage. It is discrimination and it has to stop!

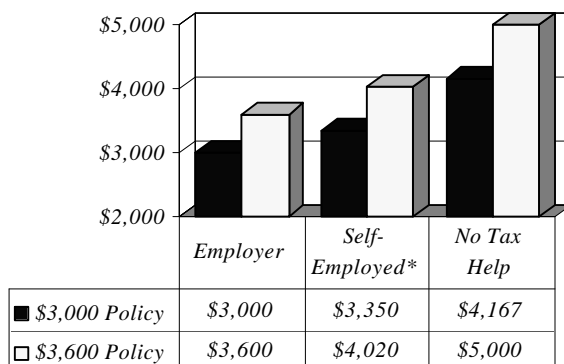
**The Financial Impact of Tax Discrimination.** This particular form of tax discrimination means that some people have to earn more money in order to buy the same policy as a self-employed worker or someone who gets health coverage from an employer.

As the figure shows:

- In order to purchase the same coverage that would cost an employer \$3,000, an individual in the 28-percent tax bracket would need to earn \$4,167 to have \$3,000 in after-tax funds. If state and local taxes were included, the individual would have to make even more.
- Because a self-employed person in the same 28-percent tax bracket gets only a 70-percent deduction, he must earn \$3,350 to buy a policy that costs an employer \$3,000.
- To purchase a policy costing \$3,600 a year, an employee without employer-provided health insurance would have to earn \$5,000, and a self-employed person would have to earn \$4,020.

**Penalizing the Poor.** Ironically, those who work for employers who don't provide insurance tend to have lower incomes than those who work for employers who do. Accord-

**How Much Does it Cost to Buy Health Insurance?**  
(assumes 28% tax bracket)



\* The self-employed receive a 70% tax deduction

Source: Mark Litow and Victoria Craig Bunce for the Council for Affordable Health Insurance

ing to a Kaiser Family Foundation survey of the uninsured for the year 2000:

- Of those under age 65 whose incomes were 100 percent of the federal poverty level (FPL) or less, 18 percent received health insurance from an employer, while 36 percent were uninsured.
- For those with incomes between 100 and 199 percent of FPL, 47 percent had employer-provided insurance and 26 percent were uninsured.
- However, for those making 300 percent of FPL or more, 87 percent had employer coverage while only 6 percent were uninsured.

Thus, the federal government is providing a sizable tax subsidy to middle- and higher-income workers and little or no help to those who can least afford health insurance coverage.

*And then we wonder why so many low-income workers are uninsured.*

**Keep Hope Alive!** The good news is that the Bush administration understands the problem and wants to fix it — now. In addition, bipartisan Congressional support for tax equity for health insurance is growing. Currently, Congress has before it more than a dozen bills that would provide a tax credit for health insurance. A tax credit is not the same as a tax deduction. With a deduction, you subtract the amount of money spent from your income, so you pay taxes on a smaller income. A tax credit, by contrast, is subtracted directly from the amount of taxes owed.

Moreover, most of the bills call for the tax credit to be “refundable,” which means that if a worker owes no income taxes (this does not apply to payroll taxes for Social Security and Medicare), the worker would receive the difference, perhaps in the form of a check or voucher (the method of distributing the money is still being debated). For example:

- A worker who owes \$5,000 in income tax and qualifies for a \$3,000 health insurance tax credit would pay only \$2,000 in taxes ( $\$5,000 - \$3,000 = \$2,000$ ). The \$3,000 would have to be used for the purchase of health insurance, and if the policy cost more, the worker would pay the difference out of pocket.
- If the same worker owed no income taxes, he or she would simply receive a credit, voucher or certificate for the full \$3,000, which would have to be used for the purchase of insurance.

The administration’s proposal and some of the bills introduced into Congress include one more provision: “advancability.”

Low-income workers targeted by the tax credit often do not have enough money to pay for a policy. Making the tax

credit advancable gets the money to workers — or insurers — up front. The lack of advancability is why some low-income families failed to use the Earned Income Tax Credit — a refundable tax credit program for low-income workers implemented in 1974 — for the purchase of health insurance.

**It’s the Cost, Stupid!** Why are so many low-income people uninsured? Because they can’t afford it. What does a health insurance tax credit do? Makes health insurance more affordable.

In “Responsible Tax Credits for Health Insurance,” health economist Mark V. Pauly and attorney John S. Hoff argue that “Many people are uninsured because the costs of care and thus the market price of insurance are too high relative to their willingness or ability to pay. [Tax] credits would reduce that price by offering individuals earmarked purchasing power; the reduced price would stimulate voluntary efforts to obtain insurance coverage.” The result likely would be fewer uninsured.

**Conclusion.** Eliminating tax discrimination in health insurance would decrease the number of uninsured, especially among low-income workers, because it would make policies more affordable.

Ironically, those who speak out against health insurance tax credits are usually middle- and upper-income political operatives who already get health insurance, along with the tax break, through their employer. They are amazingly oblivious to their inconsistency. It’s time to end the tax discrimination and give all working Americans the opportunity to join the ranks of those with health insurance.

---

Prepared by Mark Litow, Principal, Milliman USA; Victoria Craig Bunce, Director of Research & Policy, CAHI; and Merrill Matthews Jr., Ph.D., Director, CAHI.

---

Copyright © 2002 The Council for Affordable Health Insurance

All rights reserved. Reproduction or distribution without the express consent of CAHI is prohibited.

Council for Affordable Health Insurance  
112 S. West Street, Suite 400  
Alexandria, VA 22314  
Phone: 703/836-6200 Fax: 703/836-6550  
Email: [mail@cahi.org](mailto:mail@cahi.org)  
[www.cahi.org](http://www.cahi.org)