

# How the government currently helps people buy health insurance:

## The employee tax break on job-based insurance

The first pillar of the American Medical Association (AMA) proposal to expand health insurance coverage is to provide subsidies for those who need financial assistance in order to afford coverage. Although many people don't realize it, the federal government already provides more than \$125 billion a year to subsidize the purchase of private health insurance. Those who benefit from the subsidy, unfortunately, are not necessarily those who need it most. In fact, just the opposite is true. Eligibility for the current subsidy—the employee tax break on employment-based health insurance—depends only on whether an individual has employee health benefits.

Three-quarters of all people covered by employment-based insurance have household incomes greater than \$50,000, and half greater than \$75,000. By contrast, people with incomes less than \$25,000 make up only 7 percent of those with job-based coverage, which means that those who could benefit most from the subsidy—low-income individuals—are not even eligible to receive it.

Among the uninsured, two-thirds have incomes less than \$50,000. Nonetheless, 80 percent of the uninsured have one or more tax-paying workers in the household. As such, even though employment-based insurance is the most common form of health care coverage, employment in no way guarantees access to affordable care. And, unless these working taxpayers can find a way to get health benefits through their employers, they are shut out of the \$125 billion tax subsidy.

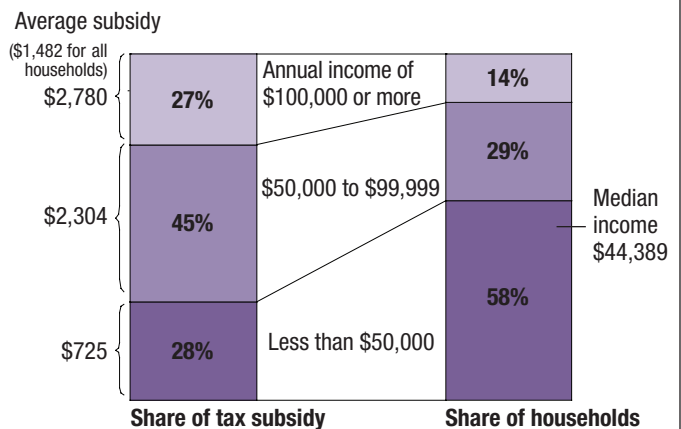
### How the current subsidy works

Under the current federal subsidy, the government subsidizes the purchase of health insurance by excluding employers' expenditures on health insurance from the employee's taxable income. The specific form of this tax break is an employee income tax exclusion. There is no evaluation of financial need, and no attempt is made to adjust for variations in plan choice (e.g., how comprehensive the coverage is) that may result in greater or lesser premiums. The amount of subsidy one receives is based on whether coverage is job-related, how expensive the premiums are, and the individual's income tax bracket. People who purchase their own health insurance, or workers who are not offered, or cannot afford, insurance through their employers, receive no tax break at all.

Moreover, the amount of subsidy increases with income, since an employee income tax exclusion benefits individuals in higher tax brackets more than those in lower tax brackets. For example, someone in the 28 percent tax bracket with health insurance benefits worth \$5,000 receives a \$1,400 income tax break (28 percent of \$5,000), whereas someone in the lower-income 15 percent tax bracket with the same health benefits receives only a \$750 tax break (15 percent of \$5,000). (See "Illustration of how tax credits or vouchers would affect households" in this series for a more detailed numerical example.) Furthermore, the relationship between income and subsidy is amplified by the fact that higher-income people are more likely to work for companies offering insurance and, on average, are offered or choose more expensive coverage. At the end of the day, the average employee tax break on employment-based insurance is nearly four times greater for households earning more than \$100,000 than for households earning less than \$50,000—that is, \$2,780 compared with only \$725.

As a result, the lion's share of the annual \$125 billion subsidy goes to those with higher incomes. As shown in the figure, more than a quarter (27 percent) of the subsidy goes to the 14 percent of households with annual incomes greater than \$100,000. Nearly three-quarters (27 percent plus 45 percent) of the subsidy goes to the less than half (14 percent plus 29 percent) of households with annual incomes greater than \$50,000. And only about a quarter of the subsidy goes to the majority (58 percent) of households earning less than \$50,000.

### Who receives the \$125 billion federal tax subsidy for employment-based health insurance, 2004<sup>a</sup>



a. Sources: Adapted from *Health Affairs* and the U.S. Census Bureau.<sup>1,2</sup>

Employers who offer health insurance to their employees generally do so in lieu of paying higher wages. If wages and health insurance premiums paid by employers are thought of collectively as income, individuals who do not receive health benefits from their employers are taxed on their full income, whereas those who participate in employment-based coverage are only taxed on a portion of their income. Moreover, if those who do not receive coverage from their employers buy coverage elsewhere, they must do so with post-tax dollars, without the help of a tax break. Thus, it can even be argued that the income tax exclusion for employment-based health insurance directs subsidies toward higher-income workers at the expense of lower-wage earners. More than 80 percent of the uninsured are workers who pay taxes—taxes that help the federal government afford to subsidize health insurance for other workers.

## Support for change

There is growing recognition that the current tax treatment of employment-based health insurance plans is unfair and fails to make the best use of public dollars to facilitate the purchase of health insurance. Over the past several years, many think tanks reflecting a range of political views have developed opinion papers and issue briefs outlining the advantages of tax credits over tax deductions and exclusions, and demonstrating how credits can be used to facilitate the expansion of health insurance coverage. Editorials in a number of major national newspapers have lamented the historical quirk that has linked employment to health insurance since wage controls were imposed during World War II.

The inequity of the tax exclusion for employment-based insurance was highlighted in 2007 when the administration proposed to eliminate the employee tax exclusion as the way to level the playing field for those who do not get health insurance through their jobs. Although the administration's proposal advocated tax deductions as the means of offering tax breaks for the purchase of private health insurance, members of Congress from both parties have introduced legislation advocating the use of tax credits to help individuals obtain health insurance.

Along with growing numbers of scholars and policymakers from diverse quarters, the AMA believes that the current tax exclusion of employment-based health insurance should be replaced by refundable, advanceable tax credits which could be awarded to individuals and families to use toward the purchase of health insurance. Eliminating or capping the tax exclusion and redirecting the subsidy toward tax credits would be a more fair and rational way to subsidize health insurance and expand coverage to the uninsured.

## A step in the right direction

The AMA recognizes that the employee income tax exclusion for job-based insurance is unlikely to be eliminated overnight. The political viability of abruptly eliminating the tax exclusion is reduced by the fact that there would be some loss of subsidy for upper-income individuals, as well as possible disruption of existing coverage arrangements. Thus, a more likely starting point would be for the government to place a limit on the existing employee income tax exclusion so that, for example, employees do not get a bigger income tax break simply for enrolling in more expensive health plans. Under this scenario, expenditures on an employee's health insurance might continue to be tax-free up to a premium limit, with additional spending for more expensive coverage becoming subject to income tax. Limiting the \$125 billion tax break on job-based insurance would yield additional revenue for the government, which could be used to fund tax credits and vouchers for those who currently get little or no assistance. The limit would also encourage insurers, employers and employees to avoid excessively generous health plans, curbing inflation in premiums and health care services.

**Visit [www.voicefortheuninsured.org](http://www.voicefortheuninsured.org) for more information on the AMA proposal and to view additional pieces in this series.**

## References

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2. DeNavas-Walt C, Proctor BD, Lee CH. *Income, Poverty, and Health Insurance Coverage in the United States: 2004*. Washington DC: US Census Bureau; August 2005. Current Population Reports, P60-229. [www.census.gov/prod/2005pubs/p60-229.pdf](http://www.census.gov/prod/2005pubs/p60-229.pdf). Accessed November 19, 2007.

