

# Illustration of how tax credits or vouchers would affect households

The first pillar of the American Medical Association (AMA) proposal to cover the uninsured is financial assistance to buy health insurance, provided through tax credits or vouchers. By giving more generous assistance to individuals and families with lower incomes, tax credits or vouchers differ fundamentally from the existing tax break on job-based insurance, which gives more assistance to higher-income workers and none to those without job-based insurance.

## Tax breaks for buying health insurance

The federal government provides more than \$125 billion per year in assistance for health insurance through the current employee income tax break, about three-quarters of which goes to households earning more than the median income. Shifting this assistance to tax credits or vouchers for people with lower incomes would reduce the number of uninsured and improve the fairness of the health care system. The most straightforward way to do this would be to eliminate the existing employee income tax break (i.e., tax exclusion) for job-based health insurance, and use the newly generated government revenues to fund tax credits and vouchers for those who currently get little or no assistance. “How the government currently helps people buy health insurance: The employee tax break on job-based insurance” in this series explains how different tax subsidies help people obtain health insurance.

## Replacing the tax exclusion with tax credits

The table on the next page illustrates how two families would be affected if the government were to replace the existing tax break for job-based insurance with tax credits. To illustrate the contrast between the status quo and the AMA proposal, the example assumes that the tax break for job-based health insurance is completely eliminated. Tax credits are introduced that follow principles advocated by the AMA—for example, being inversely related to income and large enough to make insurance affordable. The AMA reform proposal is guided by broad policy principles rather than specific parameters. As such, the AMA

proposal does *not* specify dollar amounts for tax credits, and the tax credits shown are hypothetical and illustrative. Actual changes will depend on specific tax credit amounts, income levels, tax rates, and current and future coverage choices.

## Before and after: A numerical example

The example shows that under the current employee tax exclusion for job-based insurance, Family 1 receives a subsidy of \$1,125, or 11 percent of the premium, by not paying taxes on the portion of compensation given as the employer’s share of the health insurance premium. Thus, Family 1’s effective premium is reduced from \$10,000 to \$8,875, representing 18 percent of income. Family 2 receives a subsidy of \$2,100, equal to 21 percent of the premium, making Family 2’s effective premium \$7,900, or 5 percent of family income. Note that the Family 2 receives a bigger tax break (subsidy) than Family 1, and that Family 2 effectively pays almost a thousand dollars less than Family 1 for the same coverage (\$7,900 for Family 2 compared with \$8,875 for Family 1).

## Different impacts on two families

Replacing the current tax exclusion with the hypothetical tax credit gives Family 1 a net subsidy gain of \$6,375. Family 1’s \$7,500 tax credit equals 75 percent of the \$10,000 premium, and the new effective premium, \$2,500, represents 4 percent of their taxable income. Family 2 loses its \$2,100 in subsidy, making its effective premium simply the full premium of \$10,000, or 6 percent of family income. The share of income spent on health insurance by Family 1, the lower-income family, declines significantly (from 18 percent to 4 percent), whereas the share of income spent on health insurance by Family 2 increases slightly (from 5 percent to 7 percent).

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## Impact of hypothetical tax credits on two families

Family 1	Basic family health insurance and tax information	Family 2
\$10,000	Health insurance premium	\$10,000
\$7,500	Premium paid by employer (75% of total)	\$7,500
\$50,000	Taxable income	\$150,000
15%	Tax bracket	28%

### The financial assistance received under the current employee income tax exclusion

Families 1 and 2 are both enrolled in job-based health plans with premiums of \$10,000, for which their employers pay 75% of the total premium. Both families file their income taxes jointly, but Family 2 has higher annual income than Family 1.

<b>\$1,125</b>	<b>Subsidy from the current employee income tax exclusion</b> (premium paid by employer times tax rate)	<b>\$2,100</b>
11%	Subsidy as a percentage of premium	21%
\$8,875	Effective premium (total premium minus subsidy)	\$7,900
18%	Effective premium as share of taxable income	5%

### Change in financial assistance when tax credits replace the employee income tax exclusion

Premium payments by employers on behalf of employees become subject to employees' federal income tax, while individuals and families receive tax credits toward payment of health insurance premiums (regardless of whether coverage is obtained through a job or elsewhere). In this example, Family 1 receives a \$7,500 tax credit. Family 2 does not receive a tax credit because its income exceeds a hypothetical income eligibility cutoff of \$125,000.

\$57,500	New taxable income (includes compensation from employer-paid premium)	\$157,500
\$1,125	Additional income tax (premium paid by employer times tax rate equals old subsidy)	\$2,100
<b>\$7,500</b>	<b>Subsidy from tax credit</b> (actual dollar amounts could be different)	<b>\$0</b>
+ \$6,375	Net change in subsidy	- \$2,100
75%	Subsidy as a percentage of premium	0%
\$2,500	Effective premium (total premium minus subsidy)	\$10,000
4%	Effective premium as share of taxable income	6%

