Overview of Tax Aspects of Select Health Care Reform Proposals

	President Bush[1]	Sen. McCain (R-AZ)[2]	Sen. Wyden (D-OR) Based on the Healthy Americans Act (S. 334)[3]	Sen. Obama (D-IL)
In General				
	The President's proposal would eliminate the current exclusion for employer-subsidized accident and health coverage. In lieu thereof, the proposal would provide a new "above-the-line" deduction of $7,500 per taxpayer ($15,000 for families) for the purchase of qualifying catastrophic health care insurance. The proposal would also expand Health Savings Accounts ("HSAs") by allowing individuals to make contributions to HSAs if covered by certain qualifying plans providing for 50% coinsurance.	Like the President's proposal, Sen. McCain's proposal would eliminate the current exclusion for employer-subsidized accident and health coverage. Unlike the President's proposal, however, Sen. McCain's proposal would provide a new refundable tax credit (versus deduction) equal to $2,500 per taxpayer ($5,000 for families) for the purchase of qualifying catastrophic health care insurance. The proposal would also provide for "expanded" Health Savings Accounts ("HSAs").	S. 334 (or "the bill") would establish a centrally-financed system of state-facilitated private health insurance for all Americans except for persons covered by Medicare or military-based plans. The bill would eliminate the current exclusion for employer-subsidized accident and health coverage; repeal the current employer deduction for employer-subsidized coverage; provide a federal tax subsidy with income phase-out for the purchase of qualifying medical coverage; and provide a new standard "above-the-line" deduction to assist individuals in purchasing private non-employer-based coverage. S. 334 would require that employers make "Employer Shared Responsibility Payments" to the federal government to help finance state-facilitated coverage.	Sen. Obama's proposal would preserve the exclusion for employer-provided medical coverage. Under the proposal, lower-income individuals who do not qualify for SCHIP or Medicaid, and are not otherwise covered by employer-subsidized coverage, would receive income-related federal subsidies. With certain exceptions, Sen. Obama's proposal would require employers who do not provide "meaningful coverage" or a "meaningful contribution" to the cost of health insurance for their employees to contribute a percentage of their payroll toward the costs of a national plan.
Incentives (Credits, Deductions & Exclusions)				
Income Exclusion for Employer-Subsidized Medical Coverage	The President's proposal would eliminate the current income exclusion for employer-subsidized medical coverage and replace it with a new "above-the-line" standard deduction for health insurance ("SDHI"), as discussed below. Generally, the SDHI would equal $7,500 for individual coverage and $15,000 for family coverage.	Like the President's proposal, Sen. McCain's proposal would eliminate the current income exclusion for employer-subsidized medical coverage and replace it with a new refundable tax credit, as discussed below. Generally, the refundable credit would equal $2,500 for each individual taxpayer and $5,000 for families.	The bill would eliminate the current income exclusion for employer-subsidized medical coverage. and replace it with a certain low-income subsidies and an "above-the-line" deduction for the purchase of qualifying coverage. *Comment:* Despite allowing employers to continue sponsoring certain qualifying	Sen. Obama's proposal would preserve the income exclusion for employer-subsidized medical coverage. *Comment*: Certain democratic leaders have indicated a willingness to limit or otherwise "cap" the current exclusion for employer-subsidized medical coverage, *e.g.*, Sen. Clinton's proposal

[1] President Bush's proposal is set forth as described in FY 2008 and 2009 Budget documents and a written explanation of the proposal by the Joint Committee on Taxation (JCT).
[2] The description of Sen. McCain's proposal is based, in part, on press statements made by Douglas Holtz-Eakin, Senior Domestic Policy Adviser to Sen. McCain's campaign.
[3] The Healthy Americans Act, S. 334, was introduced and referred to the Senate Finance Committee on January 18, 2007 by Sen. Ron Wyden (D-OR). On April 24, 2008, Sen. Wyden submitted an amendment to the Senate Finance Committee to amend the bill to allow for the continued sponsorship of certain qualifying employer group major medical plans.

	PRESIDENT BUSH	SEN. MCCAIN (R-AZ)	SEN. WYDEN (D-OR) THE HEALTHY AMERICANS ACT (S. 334)	SEN. OBAMA (D-IL)
INCOME EXCLUSION FOR EMPLOYER-SUBSIDIZED MEDICAL COVERAGE (CONT'D)			major medical group coverage, the bill, including proposed amendments, would eliminate the current deduction for employers for employer-subsidized coverage. Thus, it appears employers would no longer be permitted to deduct the cost of any employer-provided subsidy or premium contribution.	would limit the current exclusion to households with income not exceeding $250,000. Whether Sen. Obama's proposal will incorporate these or similar "caps" to restrict access to the current exclusion is unclear.
FICA TAX EXCLUSION FOR EMPLOYER-SUBSIDIZED MEDICAL COVERAGE	*Exclusion for employee's portion of FICA tax* – For all taxable years, employees with qualifying coverage would not be liable for the employee's share of FICA tax on the first dollar of wages up to the amount of the SDHI (*i.e.*, $7,500 with individual coverage or $15,000 with family coverage). This would be true regardless of whether the employee obtains qualifying coverage through their employer or otherwise. *Exclsuion for employer's portion of FICA tax* – For tax years prior to 2013 (the "Refund Period"), the current FICA tax exclusion for employer-subsidized coverage would be repealed with respect to the employer's share of FICA tax. During the Refund Period, all employees with qualifying coverage (regardless of whether provided through the employer or not) would be entitled to a "refund" on their annual tax return, *e.g.*, Form 1040, equal to the amount of the employer's portion of the FICA taxes paid, up to the value of the employee's SDHI. For tax year 2013 and beyond, the current FICA tax exclusion for employers would be reinstated. However, whereas the current exclusion generally is unlimited in	It does not appear that any FICA tax exclusion would remain under Sen. McCain's proposal (with respect to either the employer's or the employee's portion of FICA tax).	The bill would eliminate the current FICA tax exclusion for employer-subsidized coverage with respect to both the employer's and the employee's portions.	Although unclear, it appears that the proposal would eliminate the current FICA tax exclusion for employer-subsidized coverage with respect to both the employer's and the employee's portions.

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FICA TAX EXCLUSION FOR EMPLOYER-SUBSIDIZED MEDICAL COVERAGE (CONT'D)	amount, the new exclusion would be limited to the amount of the employee's SDHI and would be available to an employer regardless of whether the coverage is provided through the employer or not. *Comment*: Although employers would not be required to pay FICA tax on an employee's first dollar of wages up to the amount of his or her SDHI beginning in 2013, some believe that the FICA savings would be passed on to the employee in the form of increased wages over time.			
INDIVIDUAL TAXPAYER INCENTIVES	A taxpayer who purchases qualifying medical coverage, *i.e.*, coverage that equals or exceeds that provided by a specified high deductible health plan ("HDHP"), can receive an "above-the-line" SDHI equal to $7,500 for individual coverage and $15,000 for family coverage. The deduction would replace the current exclusion for most employer-provided health care coverage. Taxpayers would be entitled to the full standard deduction regardless of the actual cost of the qualifying health care coverage that the taxpayer purchases. The deduction would <u>not</u> be phased out for higher-income individuals. The deduction would increase pursuant to a cost-of-living adjustment ("COLA") based on the Consumer Price Index ("CPI"). *Comment:* Because the deduction would be indexed based on the CPI	Individuals would receive a $2,500 refundable tax credit ($5,000 for families) for the purchase of qualifying health insurance coverage. It is not entirely clear under Sen. McCain's proposal whether taxpayers would be entitled to receive the full credit regardless of the actual cost of the qualifying health care coverage purchased. Published materials state only that individuals owning certain policies costing less than the full annual credit would be permitted to deposit any remainder in "expanded" Health Savings Accounts ("HSAs") for use in meeting current and future year out-of-pocket medical expenses. *Comment:* It is unclear whether the tax credit is indexed to reflect either cost-of-living adjustments ("COLAs") generally or increases in health care costs. *Comment:* Although unclear, it appears the credit would not be	Individuals and families with modified adjusted gross incomes ("MAGI") of 100% of poverty and below will be eligible for a full subsidy with which to purchase health insurance at the state level. If MAGI is between 100% and 400% of poverty, subsidies will be provided on a sliding scale. "Employer Shared Responsibility Payments" made by employers would not be taxable income to employees. S. 334 would create a new standard "above-the-line" deduction for individuals and families above the poverty line equal to: ▪ $6,025 for an individual; ▪ $12,050 for a couple with no dependent children; ▪ $8,610 plus $1,000 per additional dependent child for a single individual with dependent children; and ▪ $15,210 plus $1,000 per additional	Individuals and families who do not qualify for Medicaid or SCHIP but still need assistance will receive income-related federal subsidies to keep health insurance premiums affordable. These subsidies could be used to buy into a new public plan or to purchase a private health care plan. *Comment:* Middle-income taxpayers who have too much income to qualify for a federal subsidy and do not otherwise receive employer-subsidized medical coverage will continue to have to pay for their own coverage.

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INDIVIDUAL TAXPAYER INCENTIVES (CONT'D)	and not actual health care costs, critics have noted that in a period of several years, the price of all qualifying coverage could outstrip the dollar amount of the proposed standard deduction. The Administration has countered that market forces would help drive down the cost of coverage because there would no longer be an employer subsidy.	subject to an income phase-out.	dependent child for a couple with dependent children. The deduction would phase out for individuals starting at $62,500 ($125,000 for joint filers). The deduction would be fully phased out at $125,000 for single filers ($250,000 for joint filers). *Comment:* Like the Bush proposal, the "above-the-line" deduction is a fixed dollar amount regardless of the amount of premiums paid by a taxpayer. Also like the Bush proposal, the deduction is indexed based on the Consumer Price Index ("CPI") and not actual health care costs.	
ADDITIONAL EMPLOYER INCENTIVES FOR ACTIVE EMPLOYEE HEALTH COVERAGE	None specified. *Comment:* Apparently, there would be no nondiscrimination requirement for employer coverage. Thus, employers who continued to provide group coverage could "pick and choose" individuals to whom they offer coverage (subject to other workplace discrimination rules such as Title VII, age discrimination, *etc.*).	None specified.	The Secretary of Health and Human Services would have discretion to provide a credit to employers who offer health insurance benefits greater than the 80th percentile of the national average in the two years prior to enactment, can demonstrate that the benefits encouraged prevention and wellness activities, and continue to provide wellness programs. Employers would be permitted to take a limited deduction for "Employer Shared Responsibility Payments". *Comment:* It does not appear that employers would be permitted to deduct the cost of any employer-paid health coverage or premium contributions.	Senator Obama's proposal would reimburse employer health plans for a portion of the catastrophic costs they incur above a threshold if they guarantee such savings are used to reduce premium costs for workers, *i.e.*, reinsurance. Small employers would be able to purchase a new public plan with federal subsidies "for those who need it." *Comment:* It is currently unclear what constitutes a "small employer" for purposes of the subsidy. The amount of the subsidy and related means test are also unknown.

	President Bush	Sen. McCain (R-AZ)	Sen. Wyden (D-OR) The Healthy Americans Act (S. 334)	Sen. Obama (D-IL)
Employer Incentives for Retiree Health Coverage	None specified.	None specified.	None specified.	None specified. *Comment:* Sen. Clinton's proposal would provide a tax credit to employers to offset certain "catastrophic expenditures" incurred in providing qualifying retiree health coverage to their employees. Whether Sen. Obama will incorporate this or a similar retiree health provision into his proposal remains unclear.
Effect on Existing Coverages and Mandatory Employer Payments				
Effect on Existing Coverages	The President's proposal would eliminate the current employer-provided exclusion for all accident and health plan coverage, including ancillary non-medical coverage, such as dental and vision coverage, employee assistance plans ("EAPs"), Medicare supplement, *i.e.*, Medigap policies, long-term care insurance, continuation coverage, and disability coverage, among others. Flexible Spending Arrangements ("FSAs") and Health Reimbursement Arrangements ("HRAs") would be eliminated since there would be no more pre-tax employer health care. Cafeteria plans would be virtually eliminated. The proposal would also expand Health Savings Accounts ("HSAs"). In addition to the high deductible health plans currently permitted, an individual would be eligible to contribute to an HSA if he or she is covered by a plan with 50% coinsurance, plus the same limits on out-of-pocket maximums.	It is unclear based on published documents exactly how the proposal would impact other employer-subsidized accident and health plan coverage; it appears that the exclusion with respect to such other coverage would be eliminated. Published materials indicate that the proposal would encourage the use of "expanded" Health Savings Accounts ("HSAs") so that individuals could control selection of their health insurance coverage. *Comment:* It is unclear what is meant by an "expanded" HSA. One could conceptualize expanding an HSA in many ways, including increasing contribution limits, allowing participants to use HSA monies for the purchase of medical coverage, and/or liberalizing the types of coverage that make one eligible for HSA contributions.	The bill, including proposed amendments, would allow employers to continue to sponsor major medical group plan coverage (subject to certain restrictions, *e.g.*, that such coverage meets certain qualifying standards). *Comment:* Under the bill, however, it appears that employers would be unable to deduct the cost of any employer-subsidized coverage or premium contribution and would remain responsible for the full amount of any Employer Shared Responsibility Payments owed, regardless of employer contribution/subsidy. Thus, there are significant disincentives under the bill, as proposed, for the continued sponsorship by employers of major medical group coverage. Like President Bush's proposal, the bill would eliminate the current exclusion for most other employer-subsidized accident and health coverages. (See discussion of President's proposal for a description of some of the employer-subsidized coverages that would be affected by the change.)	*Comment:* It is unclear how the proposal would impact employer-subsidized non-medical accident and health coverage. It appears that the exclusion would be unaffected. It appears that Flexible Spending Arrangements ("FSAs"), Health Reimbursement Arrangements ("HRAs"), and Health Savings Accounts ("HSAs") would be unaffected.

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EFFECT ON EXISTING COVERAGES (CONT'D)			As under the President's proposal, Flexible Spending Arrangements ("FSAs") and Health Reimbursement Arrangements ("HRAs") also would be eliminated. Additionally, cafeteria plans would be largely eliminated with respect to health-related benefits. The bill would allow Health Savings Accounts ("HSAs") in conjunction with high deductible health plans and would permit long-term care benefits to be offered tax-free through cafeteria plans.	
MANDATORY EMPLOYER CONTRIBUTIONS OR PAYMENTS	None specified.	None specified.	The bill would require that all employers make "Employer Shared Responsibility Payments." These payments would be a per-employee charge, which would increase based on the employer's size and revenue. *Comment:* Employer Shared Responsibility Payments would essentially constitute a per-employee tax on employers. As noted above, under the bill, including proposed amendments, it appears that employers would <u>not</u> receive a reduction in the amount of Employer Shared Responsibility Payments owed based on their payment of any direct employer-paid subsidy or premium contribution. Thus, employers that continued to sponsor group major medical plans and provide some form of subsidy to their employees with respect to such coverage would remain responsible for the full amount of any Employer Shared Responsibility Payments owed.	Sen. Obama's proposal would require employers who do not provide "meaningful coverage" or a "meaningful contribution" to the cost of health insurance for their employees to contribute a percentage of their payroll toward the costs of a national plan. Small employers that meet unspecified revenue thresholds would be exempt. *Comment:* It is not clear which employers would qualify as "small employers."