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Health Tax Proposal Analysis
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The President's FY 2008 budget, which was released yesterday, includes several tax proposals pertaining to health care. The centerpiece is a new above-the-line standard deduction for the purchase of qualifying catastrophic health care insurance. This new deduction was previewed by the President in the State of the Union address. The new health deduction would equal $7,500 for individuals who have purchased qualifying self-only coverage and $15,000 for the purchase of qualifying family coverage.

The new health deduction would replace the current income exclusion for most employer-provided health care coverage, including dental, vision, medical, accidental death and disability. Employer-provided health care coverage would be taxable just like other wages.

A taxpayer would be entitled to the full standard deduction regardless of the actual cost of the qualifying health care coverage that the taxpayer purchases. The employer would be entitled to a FICA tax exclusion on wages paid to any employee who has qualifying coverage up to the amount of the new standard deduction ($7,500 for individual coverage/$15,000 for family coverage). Thus, individuals who can purchase coverage for less than the standard deduction will receive a tax reduction.

The new health deduction would NOT phase out for higher-income individuals and all workers with qualifying coverage would benefit from the FICA tax exclusion.

In order to receive the standard health deduction, the taxpayer would have to show qualifying health coverage. Qualifying health coverage could be "purchased" from the employer on an after-tax basis (since the employer health exclusion is eliminated) or on the individual health market. The underlying

theory of the proposal is that those who do not have access to the employer market should get the same tax treatment as those who receive coverage from an employer. In many cases it will still be advantageous to obtain coverage through the employer because of group pricing. Concerns have already been expressed, however, that over time the employer group advantage will be eroded because in certain employer demographic groups the younger, healthier singles may discover that they can purchase coverage more cheaply on the individual market.

The dollar amounts of the standard health deduction would increase subject to a COLA. Note that the COLA is based upon the consumer price index and NOT on health prices. Thus, critics have noted that in a period of several years the price of all qualifying health coverage could outstrip the dollar amount of the standard health deduction. The Administration has countered that market forces will help drive down the cost of coverage because there will be no more employer subsidy.

There is no apparent nondiscrimination requirement for employer coverage. Employers who continue to provide group coverage could apparently "pick and choose" who to offer the coverage to (subject to other workplace discrimination rules such as Title VII, age discrimination, etc.).

Flexible Spending Arrangements and Health Reimbursement Arrangements would be eliminated since there would be no more pre-tax employer health care. Cafeteria plans would also be virtually eliminated.

The parameters for qualifying health coverage are:

- A limit on out-of-pocket exposure for covered expenses that is not higher than that currently allowable for Health Savings Accounts ("HSAs") (e.g., for 2007, $5,500 for self-only coverage and $11,000 for family coverage);
- Reasonable annual and/or lifetime benefit maximum;
- Coverage for inpatient and outpatient care, emergency benefits, and physician care; and
- Guaranteed renewability by the provider.
- Additionally, the budget documents make clear that the minimum coverage rules would not preempt state laws mandating certain health coverage. Thus, under the terms of the proposal, eligible coverage would be subject to applicable state health coverage mandates.

In addition to the new proposed standard deduction for health, the President's FY 2008 budget also includes several proposed expansions to HSAs. HSAs contributions would continue to be tax-deductible in addition to the new standard health deduction.

Many of the specific HSA proposals were contained in the FY 2007 budget, such as the proposal to allow for increased employer contributions to the HSAs of chronically ill employees. Certain of last year's proposed expansions, however, did not make it into this year's revenue proposal because they were rendered unnecessary by the enactment of The Tax Relief and Health Care Act in December of 2006, which, for example, provides mechanisms for individuals to transfer existing HRA balances into an HSA.

The most significant change proposed for HSAs is a new type of qualifying health insurance. In addition to current law high deductible health plans, an individual would be eligible to contribute to an HSA if he is covered by a health plan that provides for 50% coinsurance, plus all the same limitations on out-of-pocket maximums. The difference seems to be that instead of having to bear up front 100 percent of the minimum annual deductible requirement under a high deductible health plan, those costs would be spread over the year through a 50% co-insurance feature.

The proposal would also allow individuals to remain HSA-eligible and thus make contributions to an HSA despite being covered under a Flexible Spending Arrangement or Health Reimbursement Arrangement. Under the terms of the proposed expansion, amounts that could be contributed to an HSA would be reduced or otherwise offset to reflect the individual's FSA and/or HRA coverage.