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PAYING FOR HEALTH REFORM

Health reform — like the current system — has a huge price tag. The nonpartisan Congressional Budget Office estimated that the primary reform proposal in the House of Representatives would cost in excess of \$1 trillion over 10 years. Though the proposal includes numerous cost-saving measures and finances itself partly through a tax increase on the wealthiest Americans, it would still increase deficit spending by \$65 billion over 10 years.¹ President Barack Obama reiterated in a recent press conference that health-reform legislation must be deficit-neutral over 10 years.^{2,3} How to finance such a reform remains an issue as Congress weighs the several reform proposals before it. Though any number of revenue-generating measures could be used, policymakers have focused largely on three measures: implementing a graduated surcharge for the wealthiest taxpayers, limiting the value of itemized income-tax deductions for the highest-income Americans, and capping the income and payroll tax exclusion on employer-sponsored health insurance.

Graduated Surcharge — The reform bill drafted by the House Ways and Means, Energy and Commerce, and Education and Labor committees would implement a surcharge of 1 percent of income on couples earning between \$350,000 and \$500,000, 1.5 percent on couples earning between \$500,000 and \$1 million, and 5.4 percent on couples earning over \$1 million. Taxpayers filing individually would face slightly higher surcharge rates.⁴

The tax is tightly targeted; as a result, 98.8 percent of taxpayers and 96 percent of small-business owners would be unaffected by the surcharge.⁵ The small proportion of affected taxpayers has enjoyed the largest increase in after-tax income since 1979 — with inflation-adjusted income growth of 256 percent.⁶ Over the same 30-year period, the effective tax rate on the top 1 percent of taxpayers decreased from 37 percent to 31.2 percent.⁷ Middle-income taxpayers, who would be unaffected by the surcharge, have seen much more modest income growth since 1979 — with inflation-adjusted income increasing by just 21 percent.⁸ Even with the surcharge, the wealthiest Americans would pay a lower tax rate — 34.4 percent — than the 37 percent they paid in 1979.⁹

Limiting High-Income Tax Deductions — Limiting the value of itemized income-tax deductions for the highest-income taxpayers is President Obama's preferred method to raise health-reform revenues.¹⁰ The deduction benefits higher earners disproportionately. For instance, a \$100 donation to a charity would cost an individual in the 35 percent tax bracket — the highest category — only \$65, with \$35 subsidized by the itemized deduction. The same donation by an individual in a lower tax bracket — say, 15 percent — would end up paying \$85 of that donation, with only \$15 subsidized.¹¹ President Obama has proposed limiting the itemized deduction for taxpayers in the highest bracket to 28 percent.¹²

None of the current proposals being considered by Congress have included the President's proposal.¹³ However, Congress could still raise significant revenue by maintaining the current value of the itemized

deduction. The 2001 Bush tax cuts — which reduced the top income-tax brackets from 39.6 and 36 percent to 35 and 33 percent, respectively — are set to expire in 2011. But even if the marginal tax rate increases, so would the value of the itemized tax deduction.¹⁴ Letting the tax cuts expire, but keeping the value of the itemized deduction at current levels, would raise \$68 billion in revenues over 10 years.¹⁵

Capping the Exclusion of Employer-Sponsored Insurance — Employer-sponsored health insurance is currently exempt from taxation — employers do not pay a payroll tax on it, and employees are not required to calculate the value of the insurance as income. Excluding health benefits from tax is a subsidy, reducing federal tax revenues by some \$246 billion.¹⁶ If health-care costs continue to rise more quickly than inflation, then the exclusion would cost even more. Assuming the exclusion remains in place, federal tax revenues would be reduced by \$3.5 trillion dollars between 2010 and 2019.¹⁷ The sum of revenue lost to the exclusion would be more than enough to finance any of the reform proposals before Congress, which would help previously uninsured people to obtain insurance.¹⁸

The tax exclusion of employer-provided health benefits is not only the largest subsidy in the federal tax scheme, but it is also one of the more regressive elements of the tax code.^{19,20} It provides a larger benefit to wealthy taxpayers than to lower- and moderate-income Americans. A \$10,000 insurance plan, for instance, would reduce the taxable income of a worker in the 35 percent tax bracket by \$3,500. A lower-wage earner in the 15 percent bracket with the same benefits would receive a tax break of only \$1,500.²¹ About 75 percent of this subsidy goes to taxpayers earning more than the median income level.²² This is because many lower-income taxpayers do not receive employer-provided health benefits.

¹ Congressional Budget Office, Preliminary Analysis of the Insurance Coverage Specifications Provided by the House Tri-Committee Group (July 17, 2009).

² Transcript of Obama's Fifth News Conference, *New York Times* (July 22, 2009).

³ Jackie Calmes, "Obama and Congress Clash on How to Pay for Health Care." *New York Times* (June 26, 2009).

⁴ House Tri-Committee, Affordable Health Choices Act (July 14, 2009).

⁵ Chuck Marr, "House Health Bill's High-Income Surcharge: A Reasonable Approach." *Center on Budget and Policy Priorities* (July 17, 2009).

⁶ Congressional Budget Office, "Average After-Tax Income for All Households, by Household Income Category, 1979-2006" (April 2009).

⁷ CBO, "Effective Federal Tax Rates for All Households, by Comprehensive Household Income Quintile, 1979-2006" (April 2009).

⁸ CBO, "Average After-Tax Income."

⁹ Marr, *op. cit.*

¹⁰ Transcript, *op. cit.*

¹¹ Chuck Marr, "Maintaining Current Value of Itemized Deductions for High-Income Taxpayers Could Help Pay for Health Care Reform." *Center on Budget and Policy Priorities* (June 10, 2009).

¹² Jackie Calmes and Robert Pear, "To Pay for Health Care, Obama Looks to Taxes on Affluent." *New York Times* (February 25, 2009).

¹³ Transcript, *op. cit.*

¹⁴ Marr, "Maintaining Current Value..."

¹⁵ *Ibid.*

¹⁶ Paul N. Van de Water, "Limiting the Tax Exclusion for Employer-Sponsored Insurance Can Help Pay for Reform: Universal Coverage May Be Out of Reach Otherwise." *Center on Budget and Policy Priorities* (June 4, 2009).

¹⁷ *Ibid.*

¹⁸ CBO, "Cost Estimate of H.R. 3200, America's Affordable Health Choices Act of 2009" (July 17, 2009).

¹⁹ U.S. Congress, Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years 2008-2012* (Publication JCS-2-08), October 31, 2008.

²⁰ Van de Water, *op. cit.*

²¹ Lisa Clemans-Cope, Stephen Zuckerman, and Roberton Williams, "Changes to the Tax Exclusion of Employer-Sponsored Health Insurance Provides a Potential Source of Financing for Health Reform." *Urban Institute* (June 2009).

²² Jonathan Gruber, "A Win-Win Approach to Financing Health Care Reform." *New England Journal of Medicine* (June 10, 2009).