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United States General Accounting Office
Washington, DC 20548

Health, Education, and
Human Services Division

B-285141

April 21, 2000

The Honorable Charles B. Rangel
Ranking Minority Member
Committee on Ways and Means
House of Representatives

Subject: *Private Health Insurance: Potential Tax Benefit of a Health Insurance Deduction Proposed in H.R. 2990*

Dear Mr. Rangel:

Despite a strong economy, the number of nonelderly Americans without health insurance increased from about 39 million in 1994 to nearly 44 million in 1998, the latest year for which comprehensive data are available. A number of legislative proposals focus on reducing the number of uninsured and on addressing concerns about the equity of tax law as it relates to health insurance. Some of these proposals would expand the tax advantages associated with individually purchased health insurance by allowing individuals who buy health insurance either to receive a tax credit that reduces the amount of taxes they owe or to deduct the premiums they pay from their taxable income. Previously, we reported that tax credits and deductions differ with respect to who would be eligible and the amount of tax subsidy individuals would receive.[1] A tax credit typically results in the same tax benefit regardless of marginal tax rate, although the credit may be available only for individuals below a certain level of taxable income. In contrast, the value of a tax deduction is directly proportionate to marginal tax rates, so that individuals in higher tax brackets receive a larger tax advantage than those in lower tax brackets. This letter responds to your request for information on the potential tax benefit that individuals could receive if a tax

[1]See *Private Health Insurance: Estimates of Expanded Tax Deductibility of Premiums for Individually Purchased Health Insurance* (GAO/HEHS-98-190R, June 10, 1998); *Private Health Insurance: Estimates of a Proposed Health Insurance Tax Credit for Those Who Buy Individual Health Insurance* (GAO/HEHS-98-221R, July 22, 1998); and *Private Health Insurance: Estimates of Effects of Health Insurance Tax Credits and Deductions as Proposed in H.R. 2261* (GAO/HEHS-99-188R, Sept. 13, 1999).

deduction were available as proposed in H.R. 2990.[2] In particular, you asked that we estimate both the number of people who would potentially be eligible for a tax deduction under this proposal and the potential value of such a deduction.

Current tax law allows employers to deduct from their taxable income the contributions they make to their employees' health insurance premiums and excludes these contributions from the employees' taxable income. Self-employed individuals may deduct 60 percent of health insurance expenses if they are not eligible to participate in an employer-subsidized health plan.[3] In addition, any individual may claim an itemized deduction for health insurance premiums to the extent that they and all other medical expenses exceed 7.5 percent of adjusted gross income.

In summary, we estimate the following outcomes had H.R. 2990 been the law in 1998:

- About 39 million people could potentially have benefited from the proposed tax deduction: those who were uninsured and then decided to purchase coverage, those who had individual insurance, and those who had employer-sponsored insurance with no employer subsidization.

- Another 22 million potentially eligible individuals could not have benefited from the proposed deduction either because they were in the 0-percent tax bracket or because they did not file federal income taxes in 1998.

- Most of those who could have benefited from the proposed deduction—nearly 31 million—were in the 15-percent tax bracket and, at most, could have received a 15-percent reduction in premiums. Moreover, because the deductible portion of the premium would have been phased in over a 6-year period, the actual reduction in premiums could have been significantly lower until tax year 2007. We cannot estimate the percentage of people who might have purchased health insurance as a result of the proposed deduction.

- Individuals whose employers paid one-half or less of the total premium for their insurance could also have benefited from the deduction. The number of such individuals, however, is not available. An estimated 76 million people had insurance that was partially subsidized by an employer, although only a small fraction of these individuals would have been likely to benefit from the proposed deduction because most employers who sponsor health insurance pay more than half of the total premium.

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[2]H.R. 2990 was passed by the House on October 6, 1999.

[3]The portion of these expenses that are deductible will increase until it is 100 percent in 2003.

KEY FEATURES OF H.R. 2990

The tax deduction proposed under H.R. 2990 would be available to people who purchased individual health insurance or who paid 50 percent or more of the total premium for employer-sponsored insurance. The deduction would apply only to the purchase of major medical insurance and not to the purchase of supplemental policies, such as dental or vision-only plans. This deduction would be used in determining adjusted gross income, so that the tax filer would not need to itemize deductions to obtain it. Also, the tax filer would not need to meet the current threshold of 7.5 percent of adjusted gross income for medical expenses to deduct health insurance premiums. The proposed deduction would be phased in over a 6-year period, with 25 percent of the premium being deductible in tax years 2002 through 2004, and 100 percent being deductible beginning in tax year 2007 (see table 1). For self-employed individuals purchasing health insurance, H.R. 2990 would allow the 100-percent deduction of health insurance premiums starting in 2001 rather than in 2003, as is the case under current law.

Table 1: Percentage of Premium That Would Be Deductible, by Tax Year

Tax year(s)	Percentage deductible
2002, 2003, 2004	25
2005	35
2006	65
2007 and later	100

SCOPE AND METHODOLOGY

To determine the potential tax benefit of the deduction proposed in H.R. 2990, we (1) analyzed the U.S. Bureau of the Census' 1999 Current Population Survey (CPS) March Supplement for information on those potentially eligible for the deduction, including their type of health insurance, income, and tax status;[4] (2) obtained data from the KPMG 1998 Annual Survey of Employer-Sponsored Health Benefits to estimate employer premium contributions; and (3) collected data on single and family health insurance premiums available in the individual market in 1998. Although the Bureau of the Census does not directly collect information on adjusted gross income and federal tax payments, it derives estimates from simulations based on CPS data, statistical summaries of individual income tax returns compiled by the Internal Revenue Service, and data from the American Housing Survey—a survey conducted by the Bureau of the Census under sponsorship of the U. S. Department of Housing and Urban Development.

[4]The 1999 CPS March Supplement, a survey of about 47,000 households, provides data on the characteristics of the civilian noninstitutionalized population of the United States in 1998.

Our estimates reflect the number of people that could potentially be eligible for the tax deduction under H.R. 2990, which is likely to be higher than the number who would actually purchase coverage and thus receive the tax subsidy. In particular, low-income, uninsured individuals could find health insurance difficult to afford even with a tax subsidy. Our estimates also include dependents as well as tax filers in the total number of individuals who could potentially benefit from the proposed deduction and, in the case of a couple or family, are based on the assumption that one policy would cover all family members and dependents within a household. However, our estimates do not include individuals whose employer paid some, but less than half, of their premium. While such people would also be eligible for the proposed deduction, available data do not permit an accurate estimate of this population. Our estimates reflect only those individuals who were uninsured, who purchased health insurance in the individual market, or who had employer-sponsored coverage but paid the entire premium themselves. We did not examine the effect of the proposed deduction on employer sponsorship of health insurance, employer contributions for health insurance, or employee selection of employer-sponsored coverage. Neither did we examine the effect of the proposal on federal revenues. We conducted our work in April 2000 in accordance with generally accepted government auditing standards.

39 MILLION ELIGIBLES COULD HAVE BENEFITED IN 1998, BUT 22 MILLION COULD NOT

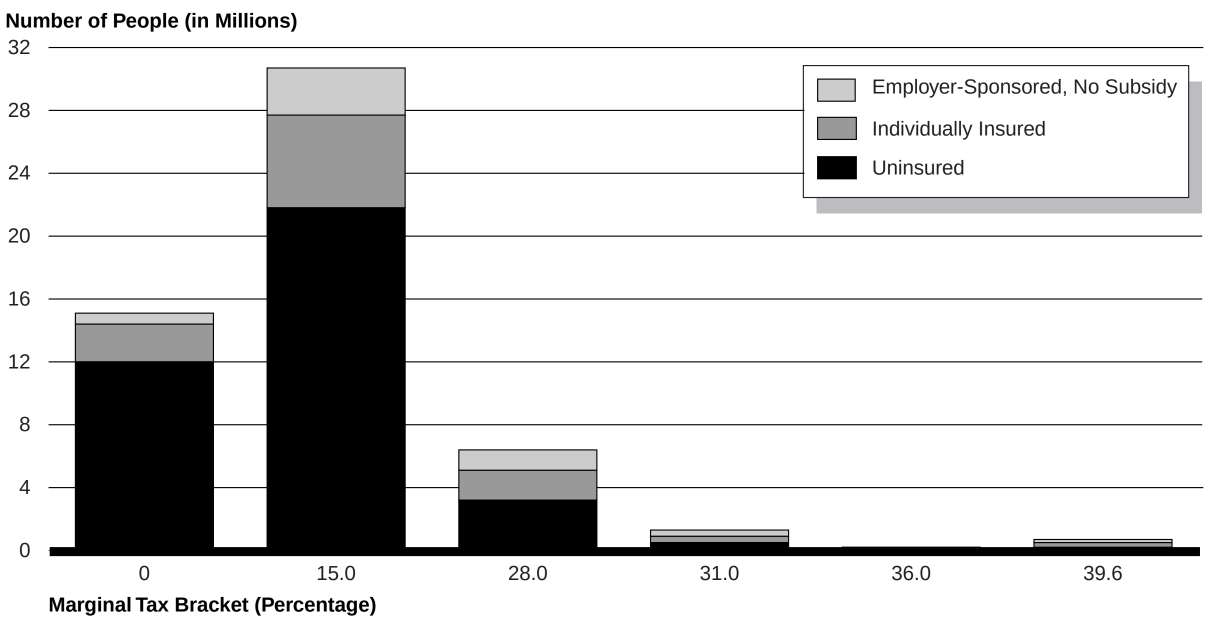
Under H.R. 2990, a tax deduction would be available to individuals with individual insurance or employer-sponsored insurance for which the employer subsidized one-half or less of the premium. Excluding those with health insurance that was, in part, subsidized by an employer, in 1998 about 39 million people could potentially have benefited from this deduction if they purchased or retained health insurance.[5] Another 22 million potentially eligible individuals could not have benefited from the proposed deduction—about 15 million individuals who were in the 0-percent tax bracket and 7 million individuals who did not file federal income taxes in 1998.

Of the 39 million people who could have benefited from the deduction, about two-thirds were uninsured and would have received the tax subsidy only if they had elected to purchase health insurance. The other one-third, including about 9 million who had purchased policies in the individual market and 5 million who had employer-sponsored coverage with no employer subsidy, would have received a tax subsidy for health insurance they were already purchasing. As shown in figure 1, most of the people who could potentially have benefited from

[5]About 2 million of these individuals could already have qualified for the health insurance deduction that is available to self-employed individuals.

the proposed deduction—nearly 31 million—were in the 15-percent tax bracket,[6] and about 15 million could not have benefited from the deduction because they were in the 0-percent tax bracket.

Figure 1: Number of Individuals Who Could Potentially Have Benefited in 1998 From the Proposed Tax Deduction, by Insurance Status and Marginal Tax Bracket



Note: Figure 1 excludes individuals with employer-sponsored coverage whose employer subsidized a portion of their premiums.

MOST EMPLOYERS SPONSORING COVERAGE PAY MORE THAN HALF OF PREMIUMS

An unknown, though likely small, number of individuals whose employers paid half or less of the premium cost would also have been eligible for the deduction in 1998. That year, about 76 million individuals had both health insurance that was partially subsidized by an employer and sufficient income for a tax deduction. Most of these people would not have been eligible for the proposed deduction, however, because most employers sponsoring health insurance pay

[6] In 1998, the 15-percent tax bracket included taxable incomes of $25,350 or less for single tax filers, $33,950 for head-of-household tax filers, and $42,350 for joint tax filers.

more than one-half of the total premium.[7] Only about 16.5 percent of employers sponsoring single coverage paid less than one-half of the total premium; 43.5 percent paid less than one-half of the premium for family coverage.[8] Most of the employers that paid less than half of premiums were small firms with fewer than 25 employees; hence, a relatively small portion of individuals with employer-sponsored coverage would have been affected.

While most employers that sponsor health insurance pay most of the premium, some kinds of employers are less likely to do so than others. In addition to small employers, employers in the construction, high-technology, and retail industries represent the largest portion of firms paying 50 percent or less of health insurance premiums. Consequently, people who receive coverage through these kinds of firms are among those most likely to benefit from the proposed tax deduction.

TAX BENEFIT INCREASES WITH MARGINAL TAX RATE

The value of a tax deduction increases relative to a person's marginal tax bracket. Thus, if the deduction proposed under H.R. 2990 was fully phased in, an eligible single tax filer in the 15-percent bracket who paid $2,658 [9] in premiums could receive a tax subsidy of about $399 from a deduction, resulting in a net cost of about $2,259 for coverage.[10] The potential deduction for this same coverage would be higher, however, for someone in a higher tax bracket. For example, an individual who was in the highest tax bracket—the 39.6-percent bracket—and had purchased this same policy could have a tax benefit of $1,053, resulting in a net cost of $1,605 for this coverage.[11] (See enclosures for more information on the estimated effects of H.R. 2990's tax deduction on 1998 taxpayers.)

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[7]The CPS does not indicate the exact percentage of health insurance premiums subsidized by employers, but only whether they pay all, some, or none of those premiums. Consequently, we could not estimate how many people with partial employer subsidies could actually benefit from the proposed deduction.

[8]Results are derived from a special analysis of the KPMG 1998 Annual Survey of Employer-Sponsored Health Benefits.

[9]This amount represents a 1998 premium in the individual market for a point-of-service plan for a single person that is available in a rural county of New York.

[10]We can not estimate the percentage of people who would purchase health insurance as a result of the proposed deduction.

[11]In 1998, the 39.6-percent tax bracket included taxable incomes of $278,451 or more but represented only a small portion of those potentially eligible for the proposed deduction.

The value of the deduction proposed under H.R. 2990 would be even more limited until 2007, when premiums would be fully deductible. For example, in the first 3 tax years, only 25 percent of paid premiums could be considered for deduction. Hence, a single tax filer in the 15-percent bracket who paid $2,658 in premiums could receive a tax subsidy of about $100. An individual in the highest tax bracket who paid this amount in premiums could receive a subsidy of about $264.

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As agreed with your office, unless you publicly announce its contents earlier, we plan no further distribution of this correspondence until 30 days after its issue date. At that time, we will make copies available to interested parties on request.

If you have any further questions regarding this letter, or if we can be of further assistance, please call me at (202) 512-7118 or John Dicken at (202) 512-7043. Staff who made major contributions to this letter include Mark Vinkenes and Paula Bonin.

Sincerely yours,

Kathryn G. Allen

Kathryn G. Allen
Associate Director, Health Financing
and Public Health Issues

Enclosures – 2

ESTIMATES OF INDIVIDUAL HEALTH INSURANCE PREMIUM DEDUCTIONS FOR SINGLE TAX FILERS, 1998

Taxable income	Marginal tax bracket	Cost of individual health insurance[b]	Net insurance cost after deduction[a]		Estimated number of nonelderly who were uninsured, were individually insured, or had employer-sponsored insurance but no subsidy (in millions)[c]
			At 25-percent deductible	At 100-percent deductible	
$0	0%	Low: $744 Medium: $2,658 High: $7,154	[d] [d] [d]	[d] [d] [d]	3.9
$1–$25,350	15.0%	Low: $744 Medium: $2,658 High: $7,154	$716 $2,558 $6,886	$632 $2,259 $6,081	11.1
$25,351 – $61,400	28.0%	Low: $744 Medium: $2,658 High: $7,154	$692 $2,471 $6,653	$536 $1,913 $5,151	1.5
$61,401 – $128,100	31.0%	Low: $744 Medium: $2,658 High: $7,154	$686 $2,452 $6,600	$513 $1,834 $4,936	0.3
$128,101 – $278,450	36.0%	Low: $744 Medium: $2,658 High: $7,154	$677 $2,418 $6,510	$476 $1,701 $4,579	[e]
$278,451+	39.6%	Low: $744 Medium: $2,658 High: $7,154	$670 $2,394 $6,446	$449 $1,605 $4,321	[e]

[a]If H.R. 2990 becomes law, the deduction will be phased in over a 6-year period, beginning at 25 percent in tax years 2002 through 2004 and then increasing to 35 percent in 2005, 65 percent in 2006, and 100 percent in 2007.

[b]The low, medium, and high premium estimates represent the variation in individual health insurance premiums that existed nationally in 1998. These premiums are examples of actual individual (as opposed to group) insurance premiums. The low premium represents an Arizona preferred provider organization's 1998 premium for a single healthy male under age 30 purchasing a $500-deductible plan. The medium premium represents a 1998 premium for a point-of-service plan for a single person that is available in a rural county of New York. The high premium represents a 1998 premium for an urban Illinois fee-for-service plan with a $250 deductible for a single male smoker aged 60 to 64.

[c]Most individuals with employer-sponsored coverage with the employer paying some, but not all, of the coverage would not have been eligible for a deduction,

because over 80 percent of employers that sponsored health insurance for singles also paid more than 50 percent of the premiums.

[d]Not applicable because individuals in the 0-percent marginal tax bracket would not have received a tax subsidy and therefore would have paid the full cost of their health insurance.

[e]The estimated number was less than 75,000—too small to be reliable, according to the CPS.

Sources: GAO analysis of March 1999 CPS data and Bureau of the Census estimates of taxable income.

ESTIMATES OF INDIVIDUAL HEALTH INSURANCE PREMIUM DEDUCTIONS FOR HEAD-OF-HOUSEHOLD AND JOINT TAX FILERS AND THEIR DEPENDENTS, 1998

Taxable income for joint tax filers[b]	Marginal tax bracket	Cost of individual health insurance[c]	Net insurance cost after deduction[a]		Estimated number of nonelderly who were uninsured, were individually insured, or had employer-sponsored insurance but no subsidy (in millions)[d]
			At 25-percent deductible	At 100-percent deductible	
$0	0%	Low: $3,180 Medium: $7,352 High: $14,233	[e] [e] [e]	[e] [e] [e]	11.3
$1–$42,350	15.0%	Low: $3,180 Medium: $7,352 High: $14,233	$3,061 $7,076 $13,699	$2,703 $6,249 $12,098	19.6
$42,351–$102,300	28.0%	Low: $3,180 Medium: $7,352 High: $14,233	$2,957 $6,837 $13,237	$2,290 $5,293 $10,248	4.9
$102,301-$155,950	31.0%	Low: $3,180 Medium: $7,352 High: $14,233	$2,934 $6,782 $13,130	$2,194 $5,073 $9,821	1.0
$155,951-$278,450	36.0%	Low: $3,180 Medium: $7,352 High: $14,233	$2,894 $6,690 $12,952	$2,035 $4,705 $9,109	0.2
$278,451+	39.6%	Low: $3,180 Medium: $7,352 High: $14,233	$2,865 $6,624 $12,824	$1,921 $4,440 $8,597	0.6

[a]If H.R. 2990 becomes law, the deduction will be phased in over a 6-year period, beginning at 25 percent in tax years 2002 through 2004 and then increasing to 35 percent in 2005, 65 percent in 2006, and 100 percent in 2007.

[b]The income brackets associated with the marginal tax rate categories for head-of-household tax filers in 1998 were lower than for joint tax filers as follows: 15-percent marginal tax rate for taxable income: from $1 to $33,950; 28-percent marginal tax: $33,951 to $87,700; 31-percent marginal tax: $87,701 to $142,000; 36-percent marginal tax: $142,001 to $278,450; and 39.6-percent marginal tax for income exceeding $278,450.

[c]The low, medium, and high premium estimates represent the variation in individual health insurance premiums that existed nationally in 1998. These premiums are examples of actual individual (as opposed to group) insurance premiums available for a family of four. The low premium represents an Arizona preferred provider organization's 1998 premium for a $500-deductible plan for two parents under 30 years old. The medium premium represents a 1998 family

premium for a point-of-service plan available in a rural county of New York. The high premium represents a 1998 premium for an urban Illinois fee-for-service plan with a $250 deductible for two parents aged 60 to 64 with a father who was a smoker.

[d]Most individuals with employer-sponsored coverage with the employer paying some, but not all, of the coverage would not have been eligible for a deduction, because over 90 percent of employers that sponsored single plus one dependent coverage also paid more than 50 percent of the premiums. More than 50 percent of employers that sponsored family coverage also paid more than 50 percent of the premiums.

[e]Not applicable because individuals in the 0-percent marginal tax bracket would not have received a tax subsidy and therefore would have paid the full cost of their health insurance.

Sources: GAO analysis of March 1999 CPS data and Bureau of the Census estimates of taxable income.

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