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Health, Education, and
Human Services Division

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July 22, 1998

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

Subject: Private Health Insurance: Estimates of a Proposed Health Insurance Tax Credit for Those Who Buy Individual Health Insurance

Dear Mr. Rangel:

This letter responds to your request for information on the potential tax benefit that individuals without employment-based health coverage would receive if a tax credit were available for the premiums of individually purchased health insurance. In particular, you requested that we estimate the number of people who would possibly benefit from a tax credit and the potential value of the tax credit as proposed in H.R. 539.

Under current law, self-employed individuals may deduct 45 percent of health insurance expenses if they are not eligible to participate in an employer-subsidized health plan.[1] 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 (AGI). Some congressional proposals would expand the tax advantages of individually purchased health insurance by allowing individuals either to deduct the premiums they pay from their taxable income or to receive a tax credit that reduces the amount of taxes they owe.

We have previously reported that about 33 million Americans who were uninsured or purchased individual health insurance in 1996 would have been eligible for a proposed tax deduction if it had been available, if they had purchased individual health insurance, and if they itemized deductions for their income tax returns rather than claimed a standard deduction. The value of a

[1]The portion of these expenses that are deductible will be phased in to 100 percent by 2007.

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health insurance tax deduction would be directly proportionate to marginal tax rates so that individuals in higher tax brackets would receive a larger tax advantage than those in lower tax brackets.[2] Thus, if the premiums were fully deductible, an individual in the highest tax bracket would receive nearly a 40-percent reduction in the cost of health insurance. Most eligible individuals–about two-thirds–are in the 15-percent marginal tax bracket, however, and therefore would receive only a 15-percent reduction.[3] Individuals who did not have any tax liability and individuals who chose not to itemize tax deductions would receive no reduction in their health insurance cost from a tax deduction. In 1995, only 5 percent of taxpayers with an AGI of less than $20,000 chose to itemize.

Unlike a tax deduction, in which the tax benefit increases according to one's taxable income, a tax credit typically operates to effect the same tax benefit among all marginal tax rates, although the credit may only be available up to a certain taxable income. Under H.R. 539, tax filers without employer-based health insurance would be eligible to receive a tax credit for up to 30 percent of the cost of individually purchased health insurance within certain limits on the basis of tax filers' AGI and amount of federal taxes paid.

To determine the possible tax benefit of this credit, we used the 1997 Current Population Survey (CPS) March Supplement and estimates of single and family health insurance premiums available through the individual market to estimate the number of nonelderly individuals without employer-based coverage that could possibly receive a full, partial, or no tax credit for health insurance premiums as proposed by H.R. 539. Although the Bureau of the Census does not directly collect information on AGI, federal tax payments, and Social Security 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. Our work was conducted in July 1998 in accordance with generally accepted government auditing standards.

In summary, nearly 40 million nonelderly Americans who were uninsured or purchased individual insurance in 1996 would have been eligible for the proposed tax credit if it had been available and they had purchased health insurance in the individual market. Those eligible for the proposed tax credit

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[2]See Private Health Insurance: Estimates of Expanded Tax Deductibility of Premiums for Individually Purchased Health Insurance, (GAO/HEHS-98-190R, June 10, 1998).

[3]In 1996, the 39.6-percent tax brackets included taxable incomes of more than $263,750. The 15-percent tax bracket included taxable incomes of less than $24,000 for single tax filers, $32,150 for head of household tax filers, and $40,100 for joint tax filers.

could have reduced the net cost of their health insurance by as much as 30 percent. The net reduction in the cost of health insurance, however, would have been less than 30 percent for many of those eligible, particularly for those buying higher priced health insurance whose income and Social Security tax payments would have been insufficient to offset the full value of the tax credit. In addition, about 10 percent of those eligible would have received only a partial tax credit because their AGI would have been too high for a full tax credit and within the range where the credit would be phased out. About 8 million nonelderly Americans who were uninsured or purchased individual insurance would not have been eligible for the tax credit because their AGI would have exceeded the maximum level set by the bill.

BACKGROUND

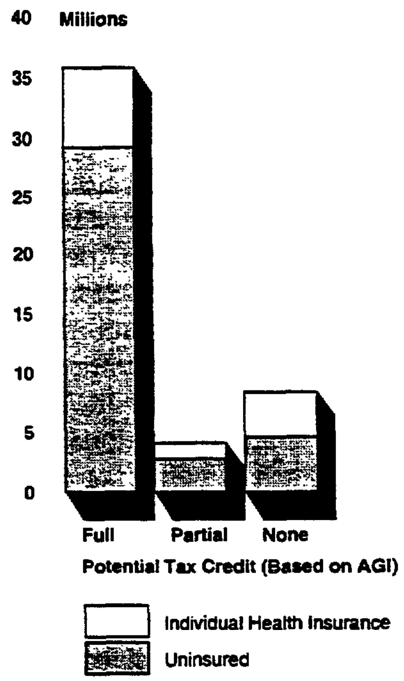
The tax credit proposed in H.R. 539 would be available to individuals without employer-based health insurance who purchased individual health insurance. The credit would be worth up to 30 percent of the amount paid for individual health insurance premiums limited by two factors: (1) the individual's AGI with the credit phased out at higher AGI amounts and (2) whether the individual made enough income and Social Security tax payments to offset the tax credit. Specifically, taxpayers filing joint returns with AGIs of $40,000 or less would be eligible for a full credit as would single or head of household tax filers with AGIs of $25,000 or less. Individuals with AGIs of up to $10,000 more than these amounts would receive a partial credit, and those with higher AGIs would receive no credit.

The bill provides that if the value of the full credit exceeds the amount of federal income taxes paid, then the tax filer may receive a refund up to the amount of Social Security taxes paid during the year. Thus, a tax filer's combined federal income and Social Security tax payments limit the total tax credit that he or she would be eligible to receive. As a result, while an individual could qualify for a full 30-percent credit toward his or her health insurance premiums on the basis of AGI, his or her actual credit could be less because the full credit amount exceeds the sum of the individual's federal income and Social Security tax payments. Moreover, those with no federal income or Social Security taxes would receive no tax credit.

MOST INDIVIDUALS WITHOUT EMPLOYER-BASED COVERAGE WOULD BE ELIGIBLE FOR THE TAX CREDIT, BUT MANY WOULD NOT RECEIVE THE FULL AMOUNT

On the basis of AGI alone, we estimate that 39.7 million nonelderly individuals without employer-based health coverage–about 74 percent–would have been eligible for the proposed tax credit in 1996 had it been available at that time and had they purchased individual health insurance. As shown in figure 1, 35.7 million (90 percent) of these individuals would have been eligible for a full credit on the basis of their AGI (if the credit did not exceed their tax payments). In addition, 31.9 million (80 percent) of the eligible individuals were uninsured and would have received a tax credit if they had purchased individual health insurance. About 8 million nonelderly individuals who were uninsured or purchased individual health insurance, however, had incomes too high to qualify for the tax credit.[4]

Figure 1: Number of People Who Were Uninsured or Purchased Individual Insurance by Potential Tax Credit Level (Based on AGI Only), 1996



Note: Under H.R. 539, a full 30-percent tax credit would be available to joint tax filers with an AGI of $40,000 or less and single and head of household tax filers with an AGI of $25,000 or less. A partial credit would be available for joint tax filers with an AGI of between $40,000 and $50,000 and single and head of household tax filers with an AGI of between $25,000 and $35,000. However, they would receive less than the full value of the tax credit if the full value of the credit exceeded their combined federal income and Social Security tax payments.

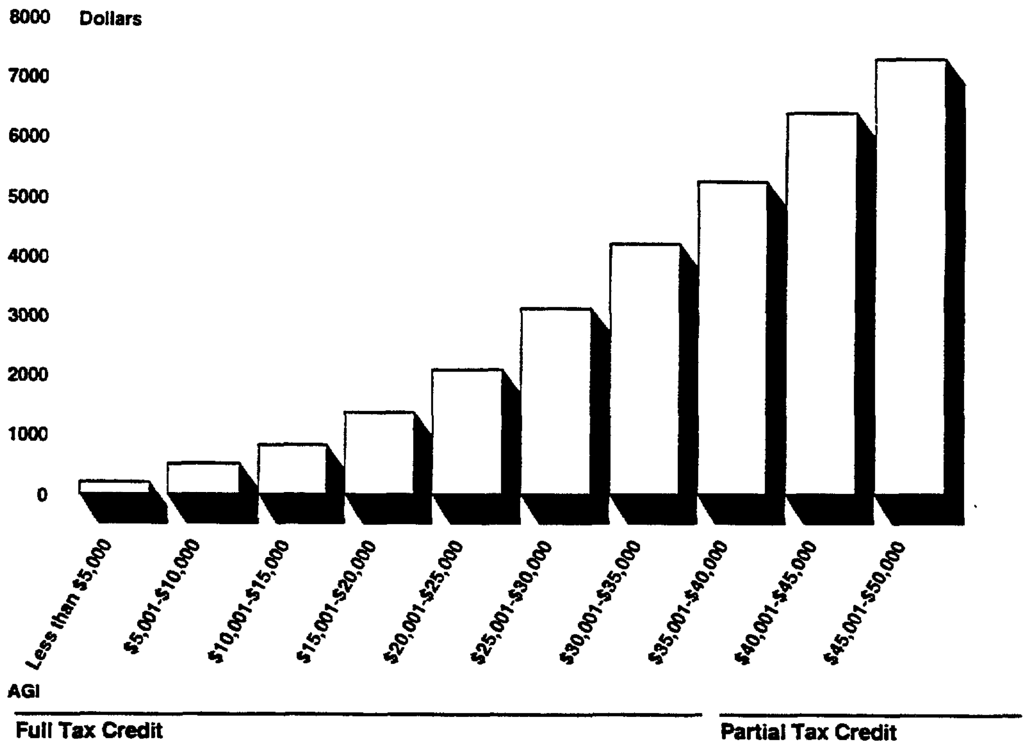
In addition to AGI, however, the amount of tax credit eligible individuals would receive is limited by the difference between (1) their combined federal income tax and Social Security tax payments and (2) the amount of the full tax credit (30 percent of the amount paid in health insurance premiums). Thus, even if an

[4]About 1.1 million eligible tax filers did not pay any federal income taxes or Social Security taxes in 1996 and therefore would not have received the tax credit. In addition, about 6 million Americans who were uninsured or purchased individual health insurance did not file federal income taxes and thus would not have been eligible for a tax credit.

individual were eligible for a full 30-percent tax credit, he or she could receive less because the full credit amount would exceed his or her total tax payments. In particular, for taxpayers in a given income group, those with higher health insurance premiums would be less likely to receive a full credit than would those with lower insurance premiums. This is because the tax credit is worth more for higher priced health insurance and fewer tax filers would have enough combined tax payments to offset the full value of the resulting tax credit than if the credit were based on low-priced health insurance.

Figure 2 shows how the average amount of combined federal income and Social Security taxes paid by joint tax filers in 1996 would increase according to filers' AGI. Among those joint tax filers eligible for a full tax credit on the basis of an AGI of $40,000 or less, the average 1996 combined federal income and Social Security tax payments varied from $200 for those with less than $5,000 of AGI compared with $5,232 for those with $35,001 to $40,000 of AGI.

Figure 2: Average Combined Income and Social Security Tax Payments for Joint Tax Filers, 1996



This variation in combined federal income and Social Security tax payments suggests that individuals with AGIs closer to the maximum allowed for a full tax credit would be more likely to receive its full value than would those with lower AGIs. This is because individuals with lower AGIs typically do not have enough income and Social Security tax payments to offset the full value of the tax credit. For example, on a medium-priced family premium of $5,664, a full tax credit would be valued at about $1,700–that is, 30 percent of the premium paid.[5] We estimate that about 40 percent of all tax filers eligible for the full tax credit on the basis of their AGI would have enough income and Social Security tax payments (at least $1,700) to receive the full tax credit at this premium level. Families with less than $20,000 of AGI typically would have received only a portion of the full tax credit at this premium level because the average combined federal income and Social Security tax payments for joint tax filers with $15,001 to $20,000 of AGI is only $1,356 and less at lower AGI categories (see fig. 2).

As shown in table 1, more tax filers would have received the full value of the tax credit if they could have purchased lower priced health insurance; fewer tax filers would have received the full value of the tax credit if their health insurance premiums were higher.[6] For example, a low-priced premium of $667 for a single person would have resulted in a potential tax credit of about $200. Because only about 14 percent of single tax filers eligible for a full tax credit had total federal income and Social Security tax payments of less than $200 in 1996, nearly 86 percent of these tax filers would have had enough combined tax payments to receive the full value of this tax credit. In contrast, a high-priced family premium of $10,000 would have resulted in a potential tax credit of about $3,000. In this case, only about 31 percent of eligible joint tax filers would have made enough income and Social Security tax payments to receive the full value of the tax credit.

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[5]Premiums vary widely in the individual health insurance market depending on the age, sex, and health status of the enrollee; geographic variations; the extent of state-imposed rate restrictions; and the characteristics of the health plan (particularly deductible levels). See Private Health Insurance: Millions Relying on Individual Market Face Cost and Coverage Trade-Offs (GAO/HEHS-97-8, Nov. 25, 1996). In our earlier letter on tax deductions for individual health insurance premiums (GAO/HEHS-98-190R) and in tables 1.1 to 1.3 in the enclosure of this letter, we base our estimates on actual low, medium, and high premiums of $684, $2,100, and $6,384 for single coverage and $2,940, $5,664, and $10,140 for family coverage.

[6]By purchasing a health plan with higher deductibles and other cost sharing, individuals can typically reduce their premium costs. However, this could result in higher overall out-of-pocket costs if they are required to pay more for health care services. Particularly for lower income families, this premium/cost sharing trade-off can pose a difficult decision.

Table 1: Examples of Percentage of Tax Filers Eligible for a Full Tax Credit on the Basis of AGI That Would Have Had Enough Tax Payments to Receive a Full Credit at Different Premium Levels, 1996

Premium	Full tax credit	Percentage of tax filers		
		Single	Head of household	Joint
$ 667	$ 200	85.9%	84.8%	94.3%
$ 2,000	$ 600	64.9%	58.3%	84.5%
$ 4,000	$1,200	47.4%	25.4%	60.9%
$ 6,000	$1,800	31.5%	14.7%	48.9%
$ 8,000	$2,400	21.1%	6.8%	39.0%
$10,000	$3,000	12.7%	3.1%	30.7%

Notes: Under H.R. 539, a full 30-percent tax credit would be available to joint tax filers with an AGI of $40,000 or less and single and head of household tax filers with an AGI of $25,000 or less. However, they would receive less than the full value of the tax credit if the full value of the credit exceeds their combined federal income and Social Security tax payments.

Single taxpayers are more likely to purchase single health coverage, which has lower premiums, than comparable family coverage more likely to be purchased by joint and head of household taxpayers.

Tables 1.1 to 1.3 in the enclosure provide more detail on the number of people who were uninsured or covered by individual health insurance in 1996 who would have been eligible to receive full, partial, or no tax credit depending on their AGI, combined tax payments, and premium level.

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As agreed with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 7 days after its issue date. At that time, we will make copies available to interested parties on request.

If you have any further questions about this letter or if we can be of further assistance, please call me at (202) 512-7114. The analysis presented in this letter was developed by John Dicken, Assistant Director, and Mark Vinkenes, Senior Social Science Analyst. Paula Bonin, Senior Computer Specialist, conducted the computer analysis of the CPS data used in this letter.

Sincerely yours,

Kathryn G. Allen

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

Enclosure

ESTIMATES OF THE EFFECT OF A FEDERAL TAX CREDIT FOR INDIVIDUAL HEALTH INSURANCE

Tables 1.1 to 1.3 present estimates of the effect of the tax credit proposed in H.R. 539 for single (table 1.1), head of household (table 1.2), and joint (table 1.3) tax filers and their dependents. The tables initially show the adjusted gross income (AGI) levels associated with each credit level and that some tax filers who are eligible for the full tax credit on the basis of their AGI would receive only a partial credit because they did not have sufficient combined federal income and Social Security tax payments to offset the full value of the tax credit.

Because estimates of the number of individuals eligible for each credit level also depend on the amount paid for health insurance premiums, the tables next present examples of low, medium, and high premium amounts. For single filers, we used premiums available in different markets for a single person in 1996. For head of household and joint tax filers, we used premiums available in different markets for a family of four in 1996. We also calculated the net cost of the health insurance after subtracting the value of the credit for tax filers with different tax credit levels and premium amounts.

Finally, the tables demonstrate that the number of people who would receive a full credit or a partial credit varies depending on combined federal tax payments and total premiums paid. As shown in table 1.1, assuming all uninsured single tax filers purchased the low-cost insurance of $684, about 8.7 million could receive a full credit, 1.2 million would receive a partial credit due to the limit of their total tax payments, 0.9 million would receive a partial credit due to their AGI, and 0.7 million would receive no credit because of their AGI. At higher premium levels, fewer tax filers would have made sufficient combined tax payments to receive the full level of the tax credit than at lower premium levels.

Table 1.1: Estimates of the Effect of Individual Health Insurance Premium Credits for Single Tax Filers, 1996

AGI	Potential level of credit	Credit percentage	Cost of individual health insurance (examples of rates for single coverage)[b]	Net insurance cost after tax credit	Estimated number of nonelderly at each credit level[a]	
					Uninsured total = 11.7 (millions)	Individually insured total = 3.5 (millions)
$25,000 or less	Full	30%	Low: $684	$479	8.7	2.1
			Medium: $2,100	$1,470	6.5	1.5
			High: $6,384	$4,469	3.1	0.7
	Partial[c] (full credit exceeds combined tax payments)	0.1 - 29.9%	Low: $684	$480 - $683	1.2	0.3
			Medium: $2,100	$1,471 - $2,009	3.3	1.0
			High: $6,384	$4,470 - $6,383	6.8	1.8
$25,001 to $34,999	Partial (based on AGI)	0.1 - 29.9%	Low: $684	$480 - $683	0.9	0.3
			Medium: $2,100	$1,471 - $2,009		
			High: $6,384	$4,470 - $6,383		
$35,000 or more	None	0%	Low: $684	$684	0.7	0.6
			Medium: $2,100	$2,100		
			High: $6,384	$6,384		

[a]The portion of people receiving the full 30-percent tax credit or a partial amount depends on the amount of premiums and federal taxes paid. At higher premium levels, the value of a full tax credit would also be higher and fewer people would have paid sufficient combined income and Social Security taxes to offset the full credit amount. For example, assuming all uninsured single tax filers purchased the low-cost insurance of $684, about 8.7 million could

receive a full credit, 1.2 million would receive a partial credit due to the limit of their total tax payments, 0.9 million would receive a partial credit due to their AGI, and 0.7 million would receive no credit because of their AGI. If these uninsured individuals purchased the high-cost insurance of $6,384, only about 3.1 million could receive a full credit and about 6.8 million would receive a partial credit due to the limit of their total tax payments.

[b]These premiums are examples of actual individual insurance premiums available in 1996. The low premium represents an Arizona preferred-provider organization's premium for a 25-year-old healthy male with a $250 deductible; the medium premium represents a community-rated fee-for-service plan in Vermont with a $1,000 deductible; and the high premium represents an urban Illinois fee-for-service plan's premium for a 60-year-old healthy male smoker. While some individuals may face either lower or higher rates than found in this range, using low, medium, and high premium estimates better represents the variation in individual health insurance premiums that exist nationally than a single "average" premium.

[c]In addition, nearly 300,000 otherwise eligible nonelderly single tax filers would not receive any tax credit because they did not make any income or Social Security tax payments.

Sources: Our analysis of Mar. 1997 Current Population Survey (CPS) data and Bureau of the Census estimates of AGI, federal income taxes, and Social Security taxes. Premium ranges are based on actual selected health insurers' rates available in 1996. For more information on how premiums vary, see Private Health Insurance: Millions Relying on Individual Market Face Cost and Coverage and Tradeoffs (GAO/HEHS-97-8, Nov. 25, 1996).

Table 1.2: Estimates of the Effect of Individual Health Insurance Premium Credits for Head of Household Tax Filers, 1996

AGI	Potential level of credit	Credit percentage	Cost of individual health insurance (examples of rates for a family of 4)[b]	Net insurance cost after tax credit	Estimated number of nonelderly at each credit level[a]	
					Uninsured total = 6.6 (millions)	Individually insured total = 1.7 (millions)
$25,000 or less	Full	30%	Low: $2,940	$2,058	2.1	0.6
			Medium: $5,664	$3,965	0.8	0.3
			High: $10,140	$7,098	0.1	0.1
	Partial (full credit exceeds combined tax payments)[c]	0.1 - 29.9%	Low: $2,940	$2,059 - $2,939	3.3	0.5
			Medium: $5,664	$3,966 - $5,663	4.6	0.8
			High: $10,140	$$7,099 - $10,139	5.3	1.0
$25,001 to $34,999	Partial (based on AGI)	0.1 - 29.9%	Low: $2,940	$2,059 - $2,939	0.5	0.2
			Medium: $5,664	$3,966 - $5,663		
			High: $10,140	$$7,099 - $10,139		
$35,000 or more	None	0%	Low: $2,940	$2,940	0.5	0.3
			Medium: $5,664	$5,664		
			High: $10,140	$10,140		

[a]The portion of people receiving the full 30-percent tax credit or a partial amount depends on the amount of premiums and federal taxes paid. At a higher premium level, the value of a full tax credit would also be higher and fewer people would have paid sufficient combined income and Social Security taxes to offset the full credit amount. For example, assuming all uninsured head of household tax filers purchased the low-cost insurance of $2,940, about 2.1 million

could receive a full credit, 3.3 million would receive a partial credit due to the limit of their total tax payments, 0.5 million would receive a partial credit due to their AGI, and 0.5 million would receive no credit because of their AGI. If these uninsured individuals purchased the high-cost insurance of $10,140, only about 0.1 million could receive a full credit and about 5.3 million would receive a partial credit due to the limit of their total tax payments.

[b]These premiums are examples of actual individual insurance premiums available in 1996 for a family of four. The low premium represents an Arizona preferred-provider organization's premium for two parents under 30 years old with a $250 deductible; the medium premium represents a community-rated fee-for-service plan in Vermont with a $1,000 deductible; and the high premium represents an urban Illinois fee-for-service plan's premium for two parents over 50 years old who smoke. While some families may face either lower or higher rates than found in this range, using low, medium, and high premium estimates better represents the variation in individual health insurance premiums that exist nationally than a single "average" premium. In addition, families with fewer than four members would most likely face relatively lower premiums.

[c]Also, about 300,000 otherwise eligible nonelderly head of household tax filers would not receive any tax credit because they did not make any income or Social Security tax payments.

Sources: Our analysis of Mar. 1997 CPS data and Bureau of the Census estimates of AGI, federal income taxes, and Social Security taxes. Premium ranges are based on actual selected health insurers' rates available in 1996. For more information on how premiums vary, see GAO/HEHS-97-8, Nov. 25, 1996.

Table 1.3: Estimates of the Effect of Individual Health Insurance Premium Credits for Joint Tax Filers, 1996

AGI	Potential level of credit	Credit percentage	Cost of individual health insurance (examples of rates for a family of 4)[b]	Net insurance cost after tax credit	Estimated number of nonelderly at each credit level[a]	
					Uninsured total = 18.1 millions)	Individually insured total = 6.5 (millions)
$40,000 or less	Full	30%	Low: $2,940	$2,058	9.5	2.3
			Medium: $5,664	$3,965	6.4	1.8
			High: $10,140	$7,098	3.7	1.2
	Partial (full credit exceeds combined tax payments)[c]	0.1 - 29.9%	Low: $2,940	$2,059 - $2,939	3.6	0.5
			Medium: $5,664	$3,966 - $5,663	6.7	0.9
			High: $10,140	$$7,099 - $10,139	9.4	1.5
$40,001 to $49,999	Partial (based on AGI)	0.1 - 29.9%	Low: $2,940	$2,059 - $2,939	1.4	0.7
			Medium: $5,664	$3,966 - $5,663		
			High: $10,140	$$7,099 - $10,139		
$50,000 or more	None	0%	Low: $2,940	$2,940	3.2	2.9
			Medium: $5,664	$5,664		
			High: $10,140	$10,140		

[a]The portion of people receiving the full 30-percent tax credit or a partial amount depends on the amount of premiums and federal taxes paid. At a higher premium level, the value of a full tax credit would also be higher and fewer people would have paid sufficient combined income and Social Security taxes to offset the full credit amount. For example, assuming all uninsured joint tax filers purchased the low-cost insurance of $2,940, about 9.5 million could receive

a full credit, 3.6 million would receive a partial credit due to the limit of their total tax payments, 1.4 million would receive a partial credit due to their AGI, and 3.2 million would receive no credit because of their AGI. If these uninsured individuals purchased the high-cost insurance of $10,140, only about 3.7 million could receive a full credit and about 9.4 million would receive a partial credit due to the limit of their total tax payments.

[b]These premiums are examples of actual individual insurance premiums available in 1996 for a family of four. The low premium represents an Arizona preferred-provider organization's premium for two parents under 30 years old with a $250 deductible; the medium premium represents a community-rated fee-for-service plan in Vermont with a $1,000 deductible; and the high premium represents an urban Illinois fee-for-service plan's premium for a two parents over 50 years old who smoke. While some families may face either lower or higher rates than found in this range, using low, medium, and high premium estimates better represents the variation in individual health insurance premiums that exist nationally than a single "average" premium.

[c]Also, about 500,000 otherwise eligible nonelderly joint tax filers would not receive any tax credit because they did not make any income or Social Security tax payments.

Sources: Our analysis of Mar. 1997 CPS data and Bureau of the Census estimates of AGI, federal income taxes, and Social Security taxes. Premium ranges are based on actual selected health insurers' rates available in 1996. For more information on how premiums vary, see GAO/HEHS-97-8, Nov. 25, 1996.

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