
**THE INDIVIDUAL TAX CREDIT PROGRAM:
ESTIMATED COST AND IMPACTS**

FINAL REPORT

Prepared For:

The Heritage Foundation

Prepared By:

Lewin/ICF

January 31, 1992

THE INDIVIDUAL TAX CREDIT PROPOSAL

Table of Contents

I. THE INDIVIDUAL TAX CREDIT PROPOSAL	
Overview of Plan	1
Federal Responsibility	2
Individual Responsibility	4
Employer Responsibility	5
Structure of Insurance Market	6
Financing	7
Key Assumptions	8
Administrative Cost Assumptions	9
II. IMPACT ON NATIONAL HEALTH SPENDING	10
III. IMPACT ON FEDERAL SPENDING	12
IV. IMPACT ON STATE & LOCAL SPENDING	14
V. IMPACT ON EMPLOYER SPENDING	16
VI. IMPACT ON HOUSEHOLD HEALTH SPENDING	18
VII. DISTRIBUTIONAL IMPACT OF ALTERNATIVE TAX CREDIT FORMULAS	21

OVERVIEW OF PLAN

- **ALL PERSONS ARE REQUIRED TO PURCHASE INSURANCE UNLESS THEY ARE OTHERWISE COVERED UNDER MEDICARE OR MEDICAID. THE MEDICARE AND MEDICAID PROGRAMS ARE RETAINED IN THEIR CURRENT FORM.**
- **THE TAX EXCLUSION FOR EMPLOYER HEALTH BENEFITS IS REPLACED WITH A REFUNDABLE TAX CREDIT FOR HEALTH INSURANCE PREMIUMS AND UNREIMBURSED MEDICAL EXPENSES.**
- **THE PRIVATE INSURANCE MARKET WOULD BE REFORMED TO MAKE A STANDARD BENEFITS PACKAGE AVAILABLE TO ALL.**
- **STATE MANDATED BENEFITS WOULD BE PREEMPTED AND RESTRICTIONS ON MANAGED CARE PLANS WOULD BE ELIMINATED.**

FEDERAL RESPONSIBILITY

- **EXISTING HEALTH TAX EXPENDITURES ELIMINATED (\$77.4 BILLION).**

- Federal tax exclusion for employer sponsored health benefits: \$66.6 billion
- Federal tax deduction for health expenses over 7.5% of AGI: \$ 2.5 billion
- State tax exclusion for employer sponsored health benefits: \$ 8.3 billion

- **REFUNDABLE TAX CREDIT FOR PREMIUMS AND UNREIMBURSED MEDICAL EXPENSES**

- Applies only in months not on Medicare or Medicaid
- IRS rules on countable expenses

- **TAX CREDIT VERSION #1**

- 80 percent of premiums up to \$275 per family member, plus
- 18 percent of premiums over \$275 per member, plus
- 18 percent of unreimbursed medical expenses.

- **TAX CREDIT VERSION #2**

Premiums and Unreimbursed Expenses as a Percent of Gross Income	Percent Reimbursed
Below 10%	21%
10% - 20%	45%
20% or More	65%

- a Includes the health care Earned Income Tax Credit (EITC) and deductions for self employed.

FEDERAL RESPONSIBILITY (Continued)

- **TAX CREDIT VERSION #3**
 - 75 percent of premiums up to \$275 per family member, plus 14 percent of premiums over \$275 plus;

Unreimbursed Expenses as a Percent of Gross Income	Percent Reimbursed
Below 10%	18%
10% - 20%	36%
20% or More	55%

INDIVIDUAL RESPONSIBILITY

- **ALL PERSONS NOT OTHERWISE COVERED BY MEDICARE OR MEDICAID ARE REQUIRED TO PURCHASE INSURANCE.**
- **MINIMUM STANDARD COVERAGE REQUIRED FOR ALL AMERICANS**
 - \$1,000 deductible (\$2,000 per family)
 - \$5,000 cost-sharing maximum

BENEFIT	COINSURANCE
Inpatient Hospital Services (365-day per stay maximum)	80%
Outpatient Hospital Services	80%
Hospital Alternatives (extended or home health care)	Yes
Physician Services	75%
Prenatal/Well-Baby/Well-Child Care	75%
Diagnostic Tests	75%
Prescription Drugs (inpatient)	75%
Emergency Services	100%
Mental Health Care	Not Covered
Dental Care	Not Covered
Vision Care	Not Covered

- **AVERAGE MONTHLY COST OF THE PLAN IS \$69.33 PER PERSON.**
- **ACTUARIAL EQUIVALENT ALTERNATIVES ARE PERMITTED.**

EMPLOYER RESPONSIBILITY

- **EMPLOYERS HAVE THE OPTION OF:**
 - Continuing to provide health benefits; or
 - Discontinuing the health plan

- **EMPLOYERS WHO CONTINUE TO PROVIDE BENEFITS:**
 - The average amount of the employer's contribution is counted as taxable income to the employee^a
 - Employees may not take cash in lieu of coverage.

- **EMPLOYERS WHO DISCONTINUE COVERAGE**
 - Employers must maintain their current level of effort by converting benefits to income
 - Employers may facilitate administration by deducting premiums for workers.

- **EMPLOYERS WILL HOLD WORKERS HARMLESS FOR THE EMPLOYER SHARE OF INCREASED FICA TAX PAYMENTS DUE TO TAXATION OF BENEFITS.**

^a Separate employer contribution amounts would be used for persons with single and family coverage.

STRUCTURE OF INSURANCE MARKET

- **INDIVIDUALS CHOSE AMONG CARRIERS COMPETING ON THE BASIS OF PRICE AND QUALITY.**
- **CURRENT MARKETING/UNDERWRITING PRACTICES MODIFIED**
 - In first year of program uninsurable individuals are randomly assigned to carriers.
 - In the initial year of the program, insurers must extend coverage to all persons they now cover.
 - In converting employer group coverage to individual or family coverage, premiums are permitted to vary by no more than 25 percent from average premiums within age, sex and geographic groups.
- **REFORM OF RENEWAL PRACTICES**
 - Guaranteed renewal
 - Renewal premium updated by carrier-wide average increase
 - Changes in renewal premiums due to changes in health status are prohibited.
- **STATE MANDATES ARE PREEMPTED BY STANDARD BENEFIT PACKAGE.**
- **LAWS RESTRICTING SELECTIVE CONTRACTING AND MANAGED CARE PLANS ARE PROHIBITED.**

FINANCING

- **THE FEDERAL TAX CREDIT WILL BE REVENUE NEUTRAL.**
 - Tax credit financed by elimination of existing health tax expenditures
 - Tax credit levels adjusted to be revenue neutral.

- **STATE AND LOCAL GOVERNMENTS WILL TRANSFER TO THE PUBLIC PROGRAM NET SAVINGS IN HEALTH SPENDING TO ASSIST IN FINANCING THE FEDERAL TAX CREDIT.**

KEY ASSUMPTIONS

- **EMPLOYERS WHO NOW OFFER INSURANCE**
 - All will discontinue coverage and convert benefits to wages
 - All firms that now insure will arrange for payroll deductions to reduce insurance administrative costs.
 - Firms with over 1,000 workers are also assumed to establish employee premium financed cafeteria plans to further reduce administrative costs.

- **WORKERS NOW COVERED BY EMPLOYER INSURANCE**
 - Those in poor/fair health will select plans that maintain their existing level of coverage
 - Those in good/excellent health will downgrade to the standard package
 - Health services utilization for persons who downgrade coverage will decline based upon price elasticities reported in the literature (a price elasticity of -0.2 was selected).

- **PERSONS NOW COVERED BY NON-GROUP INSURANCE**
 - Persons who now have coverage in excess of the minimum standard will maintain that coverage
 - Others will upgrade to minimum standard.

- **CURRENTLY UNINSURED PERSONS**
 - All will take the minimum standard package
 - Utilization will adjust to levels reported by insured persons with similar characteristics.

- **WE ASSUME NO CHANGE IN THE NUMBER OF PERSONS ENROLLED IN MEDICAID.**

ADMINISTRATIVE COST ASSUMPTIONS

- ADMINISTRATIVE COSTS WOULD BE THE SAME AS UNDER CURRENT POLICY FOR WORKERS IN FIRMS WHERE THE EMPLOYER ARRANGES EMPLOYEE DEDUCTIONS
- ADMINISTRATIVE COSTS FOR OTHERS PURCHASING INDIVIDUAL INSURANCE WOULD BE 21.9 PERCENT OF CLAIMS. THIS RETENTION RATE WAS ESTIMATED AS FOLLOWS:

**ADMINISTRATIVE COSTS FOR INDIVIDUAL COVERAGE
AS A PERCENTAGE OF CLAIMS**

	Current Policy ^a	Assumed Level Under Tax Credit ^b
Claims Administration	9.3%	8.0%
General Administration	12.5	10.0
Interest Credit	-1.5	-1.5
Risk and Profit	8.5	2.7
Commissions	8.4	0.0
Premium Taxes	2.8	2.7
Total	40.0%	21.9%

a Hay/Huggin estimates of administrative costs for groups with 1 to 4 members under current policy.

b Hay/Huggins estimates of administrative costs for groups with 1 to 4 members under a voluntary risk pooling arrangement adjusted to assume that insurer profits as a percent of claims correspond to the national average observed in the current system.

SOURCE: Congressional Research Service, "Cost and Effects of Extending Health Insurance Coverage," Washington, DC, October 1988.

**IMPACT ON NATIONAL HEALTH
SPENDING**

