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Floor Speech of Senator Chuck Grassley
on the McCain Tax Credit for Health Insurance
Delivered Tuesday, Sept. 30, 2008

I come to the floor today to talk about the tax treatment of health insurance. Republicans and Democrats who have studied the issue agree that the current tax treatment of health insurance is inequitable. Others believe that our current tax rules increase health care spending and contribute to the growing number of the uninsured. Congress needs to take a hard look at the tax code when we take up health care reform.

There are a number of ways to structure a proposal that would change the tax treatment of health insurance. Today, I want to talk about the way Senator McCain structures his proposal to change the tax treatment of health insurance.

Why? Because as the senior Republican tax-writer it is my obligation to set the record straight. For too many weeks I have heard inaccurate statements made about the McCain tax credit for health insurance proposal by the Democrats.

For example, my friend – the senior Senator from Illinois and Majority Whip – was on the floor of this chamber on Thursday, September 11th, saying that “Senator McCain will tax Americans’ health insurance.” The very next day, the junior Senator from Ohio – in an exchange with the Majority Whip – also said that Senator McCain “wants to tax those health care polices that tens of millions of Americans have.” The senior Senator from Delaware has also been saying that Senator McCain wants to tax people’s health insurance. Not on the Senate floor, but on the campaign trail and in television interviews. The junior Senator from Illinois consistently makes this explosive claim on the stump. Well, using the words of my distinguished friend – ENOUGH.

Whether or not the tax credit for health insurance proposal taxes a worker’s health insurance, the claims that have been made are half-baked. Why? Because the critics of the McCain plan fail to mention a key component of the proposal. What is it? Senator McCain would provide every American who purchases health insurance a tax credit.

It appears that the critics overlook – or maybe they just don’t understand – that the tax credit provides a bigger tax benefit to people than what they receive under the current system. So people would be better off under the McCain plan. Don’t the critics want to help low- and middle-income

workers better afford health insurance? Don't they want to help the uninsured? Senator McCain is on the side of these Americans, while his critics are favoring the status quo.

Another false claim that I have heard is that the tax credit proposal would “deny the deduction employers can take when they pay for all or a portion of their employees' health insurance.” That is flat wrong.

Even Senator Obama has said that employers will pay taxes on health insurance under the McCain plan. In the recent presidential debate, my friend from Illinois said, “Here's the only problem: Your employer now has to pay taxes on the health care that you're getting from your employer.” I'm here to tell the junior Senator from Illinois – his Democratic colleagues – and especially the American people – that Senator Obama's description of his rival's proposal is inaccurate. Employers WILL NOT pay taxes on the health insurance they offer to their workers.

Now I want to discuss how this issue is playing out in the media. Here's one instance. This past Sunday on ABC “This Week,” Senator McCain was interviewed. In the interview, Senator McCain was asked about the accuracy of Senator Obama's claim that the McCain tax credit for health insurance proposal would “tax health benefits – for the first time – by taking away the deduction that employers now get to provide health benefits.” Here are the facts. The McCain plan DOES NOT – I repeat, DOES NOT take away the EMPLOYER DEDUCTION. Employers WILL NOT pay taxes on health benefits. Businesses will continue to be able to deduct health care expenses as they do now. And they will continue to be able to provide health care as they do now. For employers, there will be NO change.

Finally – and most importantly – Senator Obama's campaign has consistently stated that the McCain tax credit proposal would “raise taxes on the middle-class.” The left-leaning think tanks funded by the likes of George Soros and company have been making the same claim. ENOUGH.

The McCain tax credit for health insurance proposal WOULD NOT increase taxes on the middle-class. To the contrary, the proposal would provide low- and middle-income workers with a tax cut. But don't take my word for it. Listen to the Tax Policy Center – a non-partisan think tank that has received notoriety for analyzing Senator McCain and Senator Obama's tax plans. The Tax Policy Center illustrates that the McCain tax credit for health insurance produces a tax cut for workers. Len Burman – the Director of the Tax Policy Center – said “It's mostly a tax break” when interviewed by CBS News on September 15th. I ask unanimous consent to place the CBS News report in the record.

Bottom line, the McCain tax credit for health insurance would not affect the employer business deduction, nor would employers pay taxes on health insurance. The proposal would not raise taxes on the middle-class, rather it would provide a tax cut for the middle-class. Finally, while the proposal taxes workers' health insurance, Senator McCain is providing these same workers with a tax credit, which is a bigger tax benefit than low- and middle-income workers receive under the current system.

But let me slow down. Let me explain how health insurance is currently taxed. Why? Because it is vitally important that my Senate colleagues and my friends in the media understand the current

rules governing the taxation of health insurance. To be clear, there are very distinct tax rules that apply to (1) an individual purchasing their own insurance, (2) an employer paying for all or a portion of its employees' health insurance, and (3) a worker purchasing insurance through their employer. Unfortunately, most people mix these tax rules up. For example, far too often I have heard people get the "employee exclusion" – which I will explain in a moment – confused with the "employer business deduction." So I have a chart here. The "employee exclusion" is NOT the same thing as the "employer business deduction." What is the "employee exclusion"? Well, a worker purchasing health insurance through his or her employer does not pay income OR payroll taxes on the cost of the health insurance policy.

In other words, the amount of health insurance coverage that is paid for by the employer is excludible from income. This means that the cost of employer-provided health insurance is not taxable for income OR payroll tax purposes. In addition, the amount of health insurance coverage that is paid for by the individual worker on their own behalf through a salary reduction arrangement reduces the worker's taxable income. This means that the worker has less income to pay income AND payroll taxes on. As the chart here says, the "employee exclusion" is the tax benefit provided to the worker.

Let's drill down on the employee exclusion for a moment. I want to explain how this tax benefit works. Tax 101 teaches us that the tax benefit that you get from a tax exclusion – just like a tax deduction – is based on the tax bracket that you are in. This means that if you are in a high tax bracket, you receive a bigger tax benefit than someone in a lower tax bracket. This is very regressive.

Here's a chart that illustrates how regressive the current employee exclusion of the cost of employer-provided health insurance really is. Here, we assumed that the average cost of a family health insurance policy is \$12,000. After all, the coverage that members of Congress get costs around \$12,000, so this is a good number to use. As you can see here, a worker in the 10% tax bracket receives a \$1,200 tax benefit. Compare this with the tax benefit that an upper-income worker receives -- which is \$4,200.

We have to ask ourselves, is it fair that low- and middle-income workers receive a smaller tax benefit for health insurance than upper-income workers receive? Now what is the "employer business deduction"? Here, an employer paying for all or a portion of its employees' health insurance can deduct the amounts they pay as an ordinary and necessary business expense, just like the employer can deduct wages. In essence, the tax code treats employer contributions for health benefits as compensation. This is consistent with how economists view employer contributions for health benefits. It's as simple as that. And it is important to note that the "employer business deduction" is the tax benefit provided to the employer.

I don't want to leave out another important tax benefit for health insurance. Or should I say the lack of a tax benefit. I am speaking about the fact that people who purchase their own health insurance generally do not receive a tax benefit under our current tax laws. In this case, the individual purchases his or her own insurance with "after-tax" dollars out of their own pocket. These individuals are able to deduct medical expenses that exceed 7.5% of their adjusted gross income, but only if the individual itemizes their deductions. Exceeding the 7.5% of adjusted gross income

threshold is not very common. That's why only about 6% of all tax returns claim the deduction, according to the IRS.

Let's now turn to how changing the current tax rules – in the same manner as contemplated by Senator McCain – would affect people and employers. I want to explain to my friends who are critics and my friends in the media how the McCain tax credit for health insurance would actually work.

Well, we can quickly cross the impact any changes would have on employers off the list right away. Why? Because – as I stated – employers WILL NOT be affected. Everyone needs to understand this key fact because the critics keep getting it wrong.

Let's talk about individuals purchasing their own health insurance. As I mentioned - under the current tax laws - these people generally do not get a tax benefit. The McCain tax credit for health insurance proposal would give these people a meaningful tax benefit for the first time!! The tax credit could be used by the individual to reduce the cost of their health insurance. In this case, the individual would not be required to spend as much of their own hard-earned money on health insurance as they do under the current system. If the tax credit exceeds the price tag of the individual health insurance policy, the excess may be used for other health care expenses, like co-pays or deductibles.

Now we get to the most important part. I'm going to explain how workers will be affected by the McCain tax credit for health insurance. I want all of my colleagues – Democrats and Republicans – and my friends in the media to pay close attention. Why? Because the senior Senator from Arizona has structured his tax credit for health insurance in a unique way.

But let's get back to the basics. As I stated, health insurance a worker purchases through his or her employer is not taxable to the worker. Again, this is referred to as the "employee exclusion." The exclusion, however, has two parts. One, the worker does not pay income taxes on the cost of the coverage. And two, the worker does not pay payroll taxes on the cost of the coverage. The proposal advanced by my friend from Arizona would maintain the payroll tax exclusion.

Let me repeat that – the cost of health insurance a worker gets through their employer would not be taxed for payroll tax purposes. This goes for the employer too. That's why I've emphasized that employers do not pay any taxes under the McCain plan.

With regard to income taxes, Senator McCain CONVERTS the current income tax exclusion into a tax credit. Let me say it another way – the McCain tax credit for health insurance proposal DOES NOT eliminate the income tax exclusion. Instead, the income tax exclusion is converted into a tax credit.

Let me pause here to go back to Tax 101. As I discussed earlier, Tax 101 teaches us that a tax exclusion – just like a tax deduction – is tied to your tax bracket. A tax credit, on the other hand, is not tied to your tax bracket. Rather, the tax credit reduces your tax liability dollar-for-dollar. This means that by definition a tax credit is more valuable to a low-income taxpayer. So, if you were to convert the income tax exclusion into a tax credit, you would effectively be increasing the tax

benefit for low-income workers. Depending on the dollar amount of the tax credit, this would be true for middle-income workers as well.

So what I am saying here? I am saying that the McCain tax credit for health insurance is effectively increasing the tax benefit for low- and middle-income workers. I am saying that the McCain tax credit makes the tax treatment of health insurance more equitable because every worker is receiving the same tax benefit. How can some of my friends on the other side oppose making the current tax treatment of health insurance more equitable?! Don't my friends want to help out low- and middle-income workers?

Let me now show my colleagues and my friends in the media how the McCain tax credit for health insurance produces a tax cut. Under the proposal, the health insurance a worker purchases through his or her employer would be taxed like compensation for income tax purposes. But unlike compensation paid in the form of wages, the proposal would NOT subject the cost of employer-provided health insurance to payroll taxes – as I've discussed. This means that the amount of tax a worker would be required to pay on the cost of their health insurance would only depend on the worker's income tax bracket.

Under the proposal, the worker would apply the tax credit against the new income tax liability that is generated from taxing the worker's health insurance. In other words, the tax credit would offset any new income tax liability. As illustrated in this chart, because the new income tax liability would be less than the tax credit amount, the worker would actually receive a tax cut.

Let's take a closer look. Here, assume a family of four purchases a family health insurance policy of \$12,000 through its employer. Under the proposal, this family would pay income taxes on the \$12,000 policy. Let's assume that this family was in the 25% tax bracket. This family would pay \$3,000 in additional income taxes.

This new tax liability, however, would be offset by the \$5,000 tax credit for family health insurance. As a result, \$2,000 would be left over. This means that the family would receive a \$2,000 tax cut. This tax cut would be greater if this family purchased less expensive coverage.

As you can see here, the tax credit for health insurance produces a tax cut for all workers. The tax cut is progressive because workers in the 10% tax bracket are receiving almost five times the tax cut workers in the 35% tax bracket receive. You can see right here that a worker in the 10% tax bracket would receive a \$3,800 tax cut. Compare that with the tax cut for an upper-income worker in the 35% tax bracket -- \$800. Now, like most campaign-related proposals, there are a number of questions of how the idea will impact people in the long run.

As the senior Republican tax-writer, I will ask these questions. And if I determine that Congress needs to tweak the proposal here – or improve the proposal there – I will recommend that we do so. But only time will tell whether we will have to undertake such an exercise.

I hope my friends on the other side and my friends in the media have heard me today. I hope that they work on getting it right. Because it is clear (1) that the McCain tax credit for health insurance produces a tax cut for workers – (2) that the McCain tax credit for health insurance provides a tax

benefit to people purchasing their own insurance for the very first time – AND (3) the proposal does not adversely impact employers in any way, shape, or form.