

Summary of Senator Grassley's Floor Speech on
Tax Issues Relating to Health Insurance

On September 30, 2008, Senator Grassley delivered a floor speech explaining (1) how health insurance is currently taxed and (2) how Senator McCain's tax credit for health insurance proposal would work. The text of the speech and charts used in the speech are available at <http://finance.senate.gov/press/Gpress/2008/prq093008j.pdf>. The speech makes the following points:

1. Under current law, 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. This tax benefit is referred to as the "employee exclusion." In the case of an employer who pays for all or a portion its workers' health insurance premiums, the employer can deduct these amounts as an ordinary and necessary business expense, just like the employer can deduct wages. This is referred to as the "employer business deduction." Individuals purchasing their own health insurance generally do not receive a tax benefit under current law.
2. Senator McCain has proposed to offer a tax credit equal to \$2,500 for single coverage and \$5,000 for family coverage to all Americans (1) purchasing health insurance in the individual (or non-group) health insurance market or (2) receiving health insurance through an employer.
3. The proposal would *not* affect the "employer business deduction." 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 benefits as they do now.
4. Under Senator McCain's plan, individuals purchasing their own health insurance would receive a tax credit for health insurance for the first time. In this case, these individuals would not be required to spend as much of their own money on health insurance as they do under the current system.
5. Under Senator McCain's plan, the tax benefit that low- and middle-income workers currently receive would be effectively increased. This is because the current "employee exclusion" is regressive. For example, a worker in the 10% tax bracket receiving a \$12,000 family health insurance policy through her employer currently receives a \$1,200 tax benefit, while a worker in the 35% tax bracket receives a \$4,200 tax benefit on the same \$12,000 family policy. Under Senator McCain's plan, these workers would receive a \$5,000 tax benefit for family health insurance coverage, which is significantly higher for, for example, a low-income worker in the 10% tax bracket (\$5,000 vs. \$1,200).

6. Under Senator McCain's plan, the income tax exclusion portion of the "employee exclusion" would be converted into an income tax credit equal to \$2,500 for single coverage and \$5,000 for family coverage. The payroll tax exclusion would be maintained. As a result, the amount of tax a worker would be required to pay on the cost of employer-provided health insurance would *only* depend on the workers' income tax bracket. Because the income tax liability that is generated from taxing the cost of employer-provided health insurance for income tax purposes would be, in most cases, less than the McCain income tax credit, workers would see a tax cut.

For example, a middle-class family of four earning \$80,000 and purchasing a family health insurance policy of \$12,000 through its employer would pay \$3,000 in additional income taxes ($\$12,000 \times 25\%$ tax bracket). 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 ($\$5,000 - \$3,000$), effectively giving this family a \$2,000 tax cut. This tax cut would be greater if this family purchased less expensive coverage.

Questions and Answers on the McCain Tax Credit for Health Insurance

Question #1: Will Senator McCain's plan tax health insurance for the first time?

Answer #1: No. Currently, people who purchase health insurance on their own already pay taxes on the amount of money they use to pay for their health insurance. Similarly, if you are a worker receiving health insurance through your employer, you will pay taxes on the amount of money that is used to pay for your health insurance under Senator McCain's plan. Under the plan, however, you will receive a tax credit equal to \$2,500 for single coverage and \$5,000 for family coverage. This same tax credit would also be available to a person purchasing their own insurance. In the case where you purchase your own insurance, you would receive a tax benefit for health insurance for the first time. If you are a worker getting health insurance through your employer, you will generally receive a bigger tax benefit for health insurance than you currently receive.

Question #2: Will Senator McCain's plan require employers to pay taxes on health insurance they provide to their employees?

Answer #2: No. Employers are not affected under Senator McCain's plan. 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 benefits as they do now.

But unlike the McCain plan, Senator Obama's plan will actually tax employers. For example, under Senator Obama's plan, if you are a small business with say – 30 employees – you're going to pay a tax if you don't offer health insurance.

Question #3: Will Senator McCain's plan raise taxes on the middle-class?

Answer #3: No. To the contrary, the McCain tax credit for health insurance would provide low- and middle-income workers with a tax cut. This is because these workers would receive a bigger tax benefit than what they currently get. Moreover, any new income tax liability would be far less than the new tax benefit. This produces a tax cut.

For example, a family of four making \$80,000 and getting a \$12,000 insurance policy through their employer will keep over \$2,000 in their own pocket. Here, the family would pay \$3,000 in additional income tax ($\$12,000 \times 25\%$). After reducing the new tax liability by the \$5,000 tax credit ($\$5,000 - \$3,000$), this middle-class family would see a \$2,000 tax cut.

Question #4: Will the tax credit for health insurance go to the insurance companies?

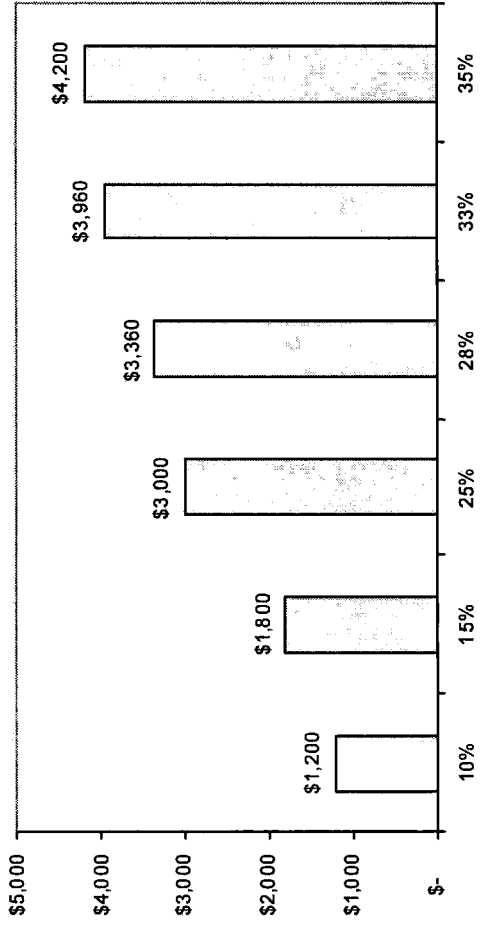
Answer #4: Under Senator McCain's plan, the tax credit is your tax benefit. You decide what type of coverage you want, and you assign your tax credit to the plan you choose to provide your health coverage. The tax credit is advanced for you each month, and for ease of administration, is delivered directly to your plan to pay your monthly premiums. Bottom-line, it is your tax credit to pay your premiums for your plan.

Question #5: Will employers drop the coverage they provide their employees?

Answer #5: Critics of the McCain plan argue that young and healthy workers will opt out of the employer-based insurance market because they can find a better deal in the individual market. These critics over look that, often times, young workers will be better off under the McCain plan if they continue to get health insurance through their employer.

For example, a young single worker making \$50,000 who is getting a \$2,500 self-only health insurance policy through his employer would pay \$675 in income taxes. But this worker would get a \$2,500 tax credit to offset the new tax liability. This leaves a \$1,875 tax cut. In order for this same worker to receive a \$1,875 tax cut, the worker would have to purchase a \$675 health insurance policy in the individual market.

Cost of Family Health Insurance Policy = \$12,000



Tax Benefit from Employee Exclusion is Inequitable

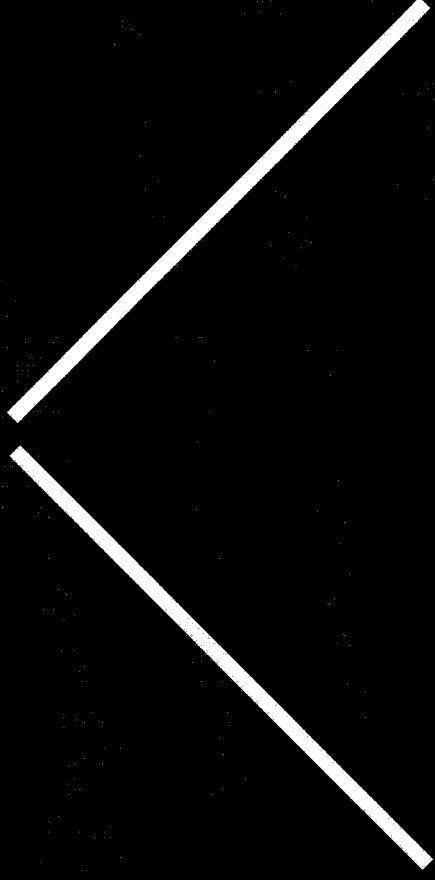
“Employee Exclusion” ≠

“Employer Business Deduction”

“Employee Exclusion” = Worker

“Employer Business Deduction” = Employer

Employee Exclusion



**Income Tax
Exclusion**

**Payroll Tax
Exclusion**

Tax Credit for Health Insurance Produces a Tax Cut

	Income Tax Liability	Tax Credit Amount	TOTAL Tax Savings
10% Bracket	\$1,200 (\$12,000 x 10%)	\$5,000	+\$3,800 (\$5,000 - \$1,200)
15% Bracket	\$1,800 (\$12,000 x 15%)	\$5,000	+\$3,200 (\$5,000 - \$1,800)
25% Bracket	\$3,000 (\$12,000 x 25%)	\$5,000	+\$2,000 (\$5,000 - \$3,000)
28% Bracket	\$3,360 (\$12,000 x 28%)	\$5,000	+\$1,640 (\$5,000 - \$3,360)
33% Bracket	\$3,960 (\$12,000 x 33%)	\$5,000	+\$1,040 (\$5,000 - \$3,960)
35% Bracket	\$4,200 (\$12,000 x 35%)	\$5,000	+\$800 (\$5,000 - \$4,200)