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Easing the Stigma of Public Coverage: Workers with Health Coverage at Their Jobs Get Significant Government Aid Too

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INTRODUCTION

Reaching the Five Percent: A Profile of Western and Central New Yorkers Without Health Coverage[1] provided a detailed analysis of the uninsured in western and central New York, finding that tens of thousands of people were eligible for public programs like Medicaid, the Essential Plan or Child Health Plus, or tax credits to make coverage more affordable. In discussion groups conducted as part of the research, about 40 residents candidly discussed barriers to coverage, including affordability (particularly for those earning between 200% and 400% of the federal poverty level); the perceived value of coverage, given the high out-of-pocket costs in many products; and the difficulty of navigating the health care system without some help. But many participants also cited another barrier—the stigma associated with enrolling in public programs or accepting financial help. This issue brief seeks to cast the decision to accept financial help for coverage in a new light by examining a large and often overlooked federal and state subsidy for coverage: the tax exclusion for employer-sponsored insurance (ESI; see box at right).

BACKGROUND

More than 156 million American have coverage through their employers, including over 9.6 million New Yorkers—about half of the state's residents.[2] The reason for the primacy of ESI in the U.S. health care system, unique among developed countries, is a well-worn tale; during a World War II-era wage freeze, employers tried to attract and retain employees by compensating them in another way—buying them group health coverage. Decisions by the IRS and Congress to give this type of compensation preferential tax treatment helped cement the role of ESI.[3] Today, the employer tax exclusion is the U.S.'s largest tax expenditure by far, estimated to reach $287 billion this year.[4]

Employees and employers benefit from the exclusion and related tax rules in many ways. First, the premiums paid by employers for workers' health coverage are not treated as wages and so are not subject to either federal or state income tax, and employers

Tax Exclusions and Tax Expenditures

The ESI tax exclusion is one example of many ways that the federal government "spends" money by excluding certain resources or funds from normal taxation under the Internal Revenue Code. This spending is accounted for and tabulated annually by the U.S. Department of Treasury and is known as a "tax expenditure." As opposed to direct spending, which is triggered by an appropriation by Congress, tax expenditures are defined as revenue losses attributable to provisions of the federal tax law, which allow a special exclusion, exemption, or deduction from gross income—or which provide a special credit, a preferential rate of tax, or a deferral of tax liability. For additional information on health care tax exclusions, see:

Urban Institute & Brookings Institution. "How does the tax exclusion for employer-sponsored health coverage work?" and "What are tax expenditures and how are they structured?" *Tax Policy Center Briefing Book: Key Elements of the U.S. Tax System.*

Rae M, Claxton G, Panchal N, and Levitt L. October 27, 2014. *Tax Subsidies for Private Health Insurance*. Henry J. Kaiser Family Foundation.

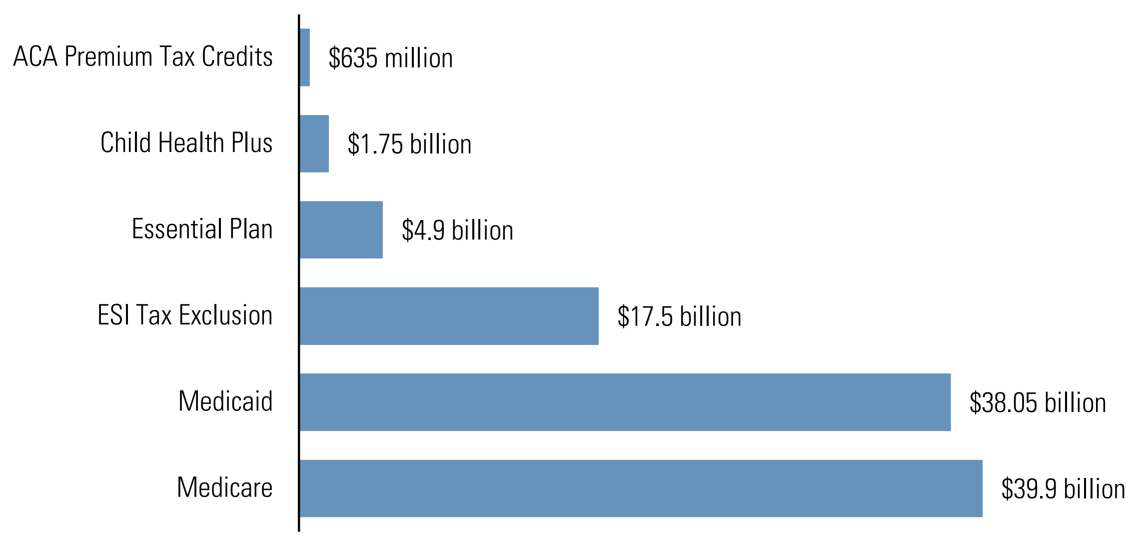
can deduct the payments as a business expense. Second, the ESI contributions are not subject to the 15.3% Federal Insurance Contributions Act (FICA) payroll tax on wages that supports Medicare and Social Security and is split equally between employers and employees. Finally, employees who contribute to the cost of their ESI typically make the payments pre-tax, before their income and FICA taxes are assessed.

THE ESI TAX EXCLUSION AND NEW YORK

The ESI tax exclusion provides a significant subsidy for New Yorkers with coverage through their jobs. Figure 1 presents an estimate of the size of the federal ESI subsidy in New York State and how it compares to other federal support and subsidies for health care.

The estimated federal tax expenditure for New York's share of the ESI tax exclusion is about $17.5 billion. This far exceeds direct federal spending on Affordable Care Act premium tax credits, the Child Health Plus program, and the Essential Plan, and amounts to nearly half of federal expenditures for Medicaid and Medicare in New York. Since federal tax code provisions "flow through" to state income tax codes, unless explicitly "de-coupled," the full value of the ESI exclusion exceeds $22.65 billion when New York's estimated $5.151 billion tax expenditure is figured in.[5]

Figure 1. Selected Federal Health Care Tax Expenditures and Direct Spending in New York



Source and notes: See appendix.

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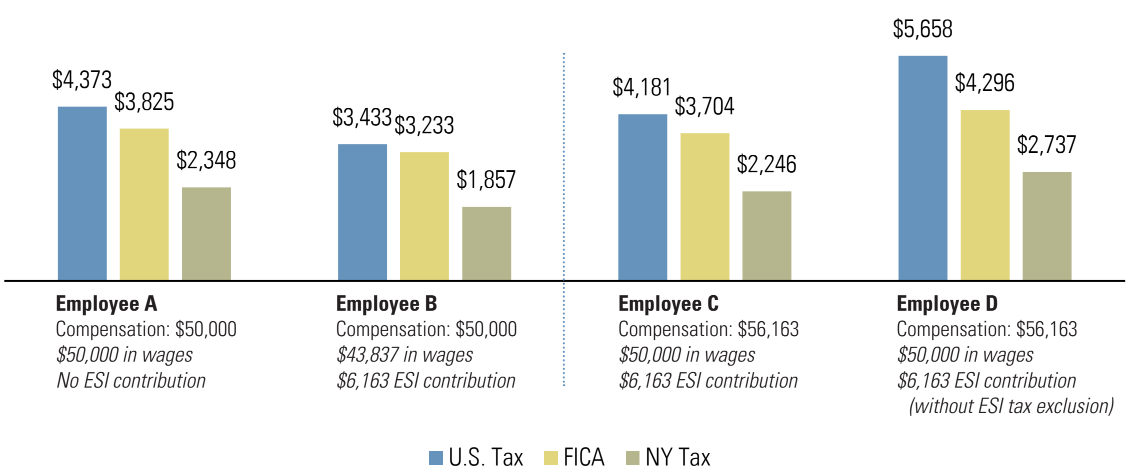
ESI TAX EXCLUSION BENEFITS FOR INDIVIDUALS IN NEW YORK

To show how the ESI tax benefits flow to typical individuals, taxes were calculated for four fictitious employees with similar circumstances. All four employees have no dependents to declare, are not subject to state or federal adjustments, and take the standard deduction on state and federal taxes. As shown in Figure 2, Employee A receives compensation of $50,000 (all in wages), and Employee B receives compensation of $50,000 (wages of $43,837 and an employer ESI contribution of $6,163 annually). Employees C and D receive total compensation of $56,163 ($50,000 in wages and an employer contribution for health coverage of $6,163). In order to demonstrate the value of the federal ESI tax exclusion another way, the hypothetical tax calculation for Employer D was made as if the exclusion did not exist. Therefore, Employee D's taxable income includes $50,000 in wages and the whole amount of the employer's $6,163 contribution for health insurance.

Because of the preferential tax treatment for ESI, Employee B saves about $2,000 on taxes annually compared to Employee A—about $170 a month—paying lower federal and state income and FICA payroll taxes. It's a different story for Employee D, whose taxes were calculated without the favorable ESI provisions. Compared to Employee C, the overall tax burden for Employee D increases by over $2,500 annually, because the employer contribution toward ESI is included in income and the employee cannot make the annual employee contribution toward ESI of $1,578 on a pre-tax basis. Employee C also enjoys a modestly lower tax bite than Employee A, even though they receive the same wages.

Figure 2. How the ESI Exclusion Affects the Tax Bill for Individuals



Source and notes for Figure 2: See appendix.

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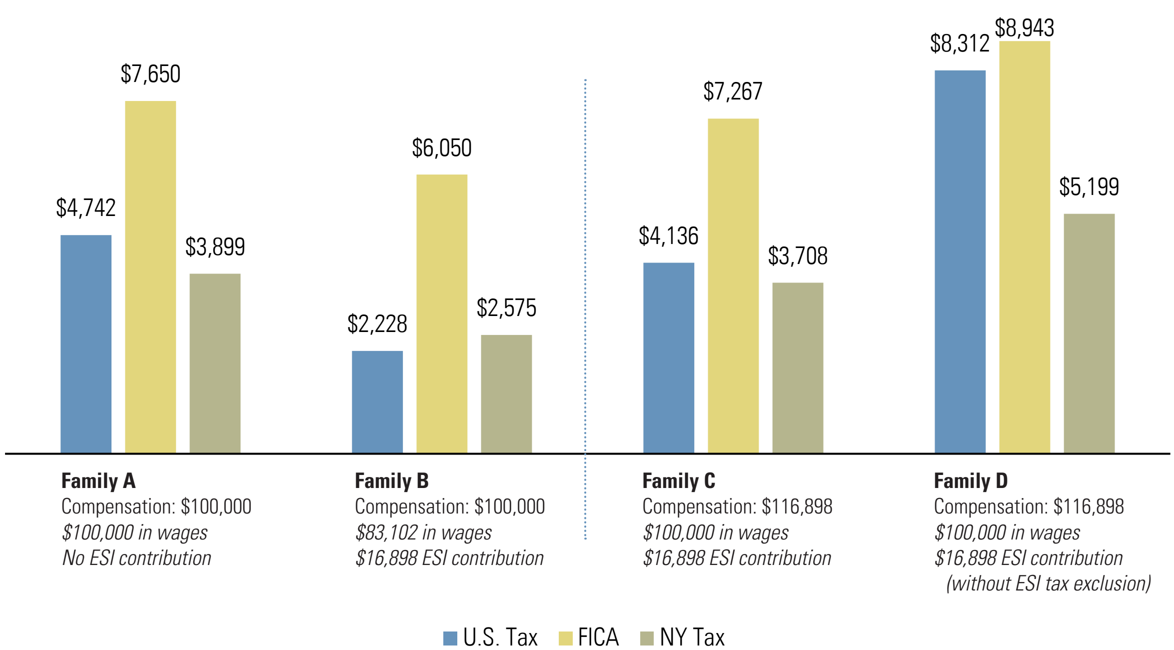
ESI TAX EXCLUSION BENEFITS FOR FAMILIES IN NEW YORK

A similar dynamic plays out for families, as shown in Figure 3. In this example, taxes were calculated for four fictitious families of four, all married filing jointly, using the standard deductions, and eligible for the federal child credit and state child deduction and credit. Current tax rules were applied to Family A (with income of $100,000, all in wages) and Family B (also with an income of $100,000, including $83,102 in wages and $16,898 from an employer ESI contribution). Families C and D both received total compensation of $116,898 ($100,000 in wages and $16,898 from their employer's contribution to health insurance). As in Figure 2, in order to demonstrate the value of the federal ESI tax exclusion for families another way, the tax calculation for Family D was made as if the federal ESI tax exclusion did not exist. Therefore, Family D's taxable income includes $100,000 in wages plus the whole amount of the employer's $16,898 contribution for health insurance.

Even though they have the same overall level of compensation—$100,000—Family B enjoys a savings of about $5,400 annually compared to Family A (about $455 a month) because of the ESI preferential treatment, as federal and state income taxes and FICA are all reduced. And without these favorable ESI tax provisions, Family D (with the exact same benefit package as Family C) would pay about $7,300 more in taxes annually compared to Family C. To put it another way, federal and state subsidies for ESI save Family C over $7,300 annually—enough for a Buffalo resident to pay 12 months of premiums for a gold-level individual plan from New York's marketplace in 2019.

Figure 3. How the ESI Exclusion Affects the Tax Bill for Families



Source and notes for Figure 3: See appendix.

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CONCLUSION

Although the ESI tax exclusion is largely hidden, it has generated considerable debate for decades. The exclusion regularly turns up on lists of actions the U.S. could take to reduce the federal deficit.[6] Critics argue that the exclusion encourages excessive health spending, is regressive[7] (since higher-income individuals receive a disproportionate share of the benefits), and that the money could be better spent providing coverage for the uninsured. Others have challenged the notion that the exclusion is regressive, noted the importance of the exclusion (despite its flaws) to the large group pooling mechanism, and warned of disrupting ESI coverage for vulnerable families by getting rid of or capping the exclusion.[8] Most recently, the possible repeal of the Affordable Care Act's "Cadillac tax" on high-cost employer plans[9] has put the exclusion in the news. Were the nation to adopt a single-payer system, of course, the tax exclusion for ESI would be a thing of the past.

As one observer noted, the "huge tax subsidy is so hidden, [it allows] prosperous employed workers to believe that other people—certainly not we ourselves—are beneficiaries of the American social welfare state." [10]

Regardless of the policy outcome, increasing awareness about the ESI tax exclusion—its size and its beneficiaries—should help change some attitudes. First, for uninsured New Yorkers, who were raised to be self-reliant and might be ashamed to accept help, the knowledge that fellow New Yorkers with ESI—the "haves" of the health care system—are reaping the benefit of nearly $23 billion in tax subsidies annually should ease any stigma associated with enrolling in public coverage or applying for advanced premium tax credits. And second, as one observer noted, the "huge tax subsidy is so hidden, [it allows] prosperous employed workers to believe that other people—certainly not we ourselves—are beneficiaries of the American social welfare state."[10] Once aware of the benefits they receive—let's call it the paystub test—New Yorkers with ESI may think twice about criticizing public spending for the uninsured, or casting aspersions on those who do accept financial help for coverage.

ACKNOWLEDGMENTS

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APPENDIX: METHODOLOGY

Figure 1

Sources for the totals in Figure 1 are as follows:

For ACA premium tax credits, the NYSOH enrollment report for 2019 (https://info.nystateofhealth.ny.gov/2019openenrollmentreport)

For Child Health Plus and the Essential Plan, the FY2019-2020 Aid to Localities budget bill (S1503-D/A2003-D, Department of Health)

For ESI tax exclusion, the total federal expenditure ($287 billion) multiplied by New York's pro rata share of all employer-sponsored coverage using Henry J. Kaiser Foundation Kaiser State Health Facts, Health Insurance Coverage of the Total Population. (https://www.kff.org/other/state-indicator/total-population/?currentTimeframe=0&sortModel=%7B%22colId%22:%22Location%22,%22sort%22:%22asc%22%7D)

For Medicaid, Report on the State FY 2018-19 Enacted Budget Financial Plan and Capital Program and Financing Plan, New York State Office of the Comptroller (https://www.osc.state.ny.us/reports/budget/2018/2018-19-enacted-budget-financial-plan-july.pdf)

For Medicare (2014), Henry J. Kaiser Family Foundation, State Health Facts, Medicare Spending, Total Medicare Spending by State (https://www.kff.org/medicare/state-indicator/medicare-spending-by-residence/?currentTimeframe=0&sortModel=%7B%22colId%22:%22Location%22,%22sort%22:%22asc%22%7D)

An alternative estimate of New York's share of the total federal ESI exclusion expenditure (multiplying the total number of New Yorkers with ESI by CBO's average per capita expenditure of $1,810) produces a similar estimate of $17.26 billion. Both estimates are probably conservative since New York's average single premium for private employers exceeds the U.S. average by $1,062 and for family premiums, by $2,338; premiums for public employees are likely higher, because the collective bargaining process generally results in lower-cost sharing and premium contributions for employees and higher premium contributions for employers.

Figures 2 and 3

A 2014 publication, *Tax Subsidies for Private Health Insurance* (https://www.kff.org/private-insurance/issue-brief/tax-subsidies-for-private-health-insurance/) served as a useful guide for constructing the hypothetical tax returns for individual and families used as examples in Figures 2 and 3. Regular 2018 tax forms and instructions for form 1040 for federal and IT-201 for state returns were used to calculate these returns. In order to simplify the exercise, the hypothetical taxpayers reported only wages (and no interest, dividend, or other income); used standard deductions, rather than itemizing; had no applicable state or federal modifications; and did not live in New York municipalities where personal income taxes are levied. In recent years, about 30% of taxpayers nationally, mostly high-income filers, itemized deductions on their returns. (Urban Institute and Brookings Institution. *Tax Policy Center Briefing Book: Key Elements of the U.S. Tax System*. What are itemized deductions and who claims them? https://www.taxpolicycenter.org/briefing-book/what-are-itemized-deductions-and-who-claims-them) That percentage is expected to decrease because of Tax Cut and Jobs Act limitations on itemized deductions, and higher standard deductions.

Families in our examples also filed using the standard federal child tax credit and New York child deduction, and, for those eligible, the Empire State Child Tax Credit. For individuals and families with health insurance, the average New York single and family premiums and employee contributions from an annual federal survey were used. (Tables II.C.1.and 2 and II.D.1. and 2. from the Agency for Healthcare Research and Quality, Center for Financing, Access and Cost Trends. 2018 Medical Expenditure Panel Survey-Insurance Component. https://meps.ahrq.gov/mepsweb/data_stats/quick_tables_results.jsp?component=2&subcomponent=2&year=2018&tableSeries=-1&tableSubSeries=&searchText=&searchMethod=1&Action=Search)

An assumption was made that Employees B and C and Families B and C worked for firms that maintain IRS Code section 125 cafeteria plans that allow employees to take pre-tax deductions for their contributions toward coverage, thus reducing their taxable income. According to a 2012 survey, 41% of small firms (3-199 workers) and 91% of larger firms offered employees this option. (Kaiser Family Foundation and Health Research Education Trust. *Employer Health Benefits 2012*. https://www.kff.org/wp-content/uploads/2013/04/8345.pdf)

For Employee D and Family D, an assumption was made that these employees could not make pre-tax contributions toward coverage, and ESI contributions were not excluded from income—so federal, state, and FICA taxes were calculated as if these contributions were taxable income. Other health-related tax benefits available to employees and individuals were not discussed in this issue brief. Both employees and individuals may have access to Health Savings Accounts. In addition, self-employed individuals can deduct health insurance premiums, and individuals with coverage can deduct personal medical expenses (except prescription drugs) exceeding 10% of adjusted gross income. Nationally, U.S. tax expenditures for these three categories totaled $18.67 billion in 2018, a fraction of the tax exclusion for ESI. (U.S. Department of the Treasury, Office of Tax Analysis. Tax Expenditure. October 19, 2018. https://home.treasury.gov/system/files/131/Tax-Expenditures-FY2020.pdf)

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ENDNOTES

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