

## TAX CREDITS VERSUS TAX DEDUCTIONS FOR HEALTH CARE COVERAGE

### Why the Bush Tax Deduction Is Unhelpful and Regressive

#### Introduction

President Bush plans to propose a tax *deduction* of \$7,500 for individuals and \$15,000 for families who purchase health insurance. An understanding of the differences between tax *credits* and tax *deductions* shows why the Bush proposal will not help most uninsured Americans—and why it is regressive.

There is an enormous difference between tax deductions and tax credits as a means of making health coverage affordable. This is an especially important difference for people with moderate incomes – the people most likely to find health care unaffordable today.

A tax credit can reduce taxes on a dollar-for-dollar basis. A hypothetical \$15,000 credit would provide \$15,000 in tax relief. On the other hand, only a portion of a tax deduction is passed on to taxpayers, and the amount is dependent on their tax bracket. For a family in a 15 percent tax bracket, a tax deduction reduces their tax liability by only \$0.15 for every \$1.00 spent on premiums. With family health coverage now estimated to cost approximately \$12,000 per year, families with modest incomes would still have to pay close to \$10,000 in premiums, plus additional amounts in deductibles and copayments.

Tax deductions are regressive. Since the amount of tax relief offered by a deduction depends on the individual's tax bracket, the higher the income, the greater the tax relief. As a result, two families purchasing the exact same health insurance could receive very different deductions, with the higher-income families who need help the least receiving tax breaks twice as large as families with more moderate incomes.

What's more, many of the uninsured have such low incomes that they have little or no tax liability. Approximately two-thirds of the uninsured have incomes below 200 percent of the federal poverty level (\$33,200 in annual income for a family of three, \$40,000 for a family of four).

To assist these lower-wage working families so that health insurance is affordable, the tax credit must be substantial – and for many who have no tax liability, the tax credit needs to be *refundable*. Also, for lower-wage working families, the tax credit needs to be *advanceable* so that they receive the credit at the time they need to pay their insurance premiums, not on or around April 15 of the subsequent year. These concepts are described below.

## Why a Tax Deduction Is Inadequate and Regressive

With a tax deduction, individuals subtract a specified amount from their taxable income before calculating their tax liability. Tax deductions reduce the amount of taxes owed by a percentage of the amount deducted (often referred to as their “tax bracket”). The tax brackets for single people and married couples filing jointly are as follows:

For Singles		For Families	
Taxable Income	Tax Bracket	Taxable Income	Tax Bracket
\$7,825-31,850	15%	\$11,200-42,650	15%
31,850-77,100	25%	42,650-110,100	25%
77,100-160,850	28%	110,100-178,350	28%
160,850-349,700	33%	178,350-349,700	33%
Over 349,700	35%	Over 349,700	35%

A \$15,000 tax deduction is worth only \$2,250 to a family with \$40,000 in taxable income, but it is worth more than twice that amount—\$4,950—to families with \$200,000 in taxable income. Hence, it is clearly regressive.

A tax deduction for health care coverage is regressive in another way as well. In order to receive the benefit of the health care tax deduction, the family must have enough money to purchase health coverage. If the potential tax benefit is too small to enable the family to obtain health coverage, the family would receive no deduction at all. Most of the uninsured, who are in lower-wage jobs, will not qualify for the deduction and will receive no tax benefit at all.

## Why a Tax *Credit* Should Be Refundable

A tax credit is a dollar-for-dollar reduction in the amount of taxes a family owes. Some tax credits are “refundable,” meaning that, if a family owes less in taxes than the amount of the credit, it receives a payment for the additional amount and benefits from the full amount of the credit. The Earned Income Tax Credit is an example of a well-known federal program that works in such a manner: Individuals with low incomes may either have their taxes reduced or may get a refund if the amount of the credit exceeds their tax liability.

Most of the uninsured are in low-wage jobs. As a result, their tax liability is often considerably less than \$15,000. Therefore, a tax credit for health coverage will provide meaningful help only if it is refundable.

## Why a Tax *Credit* Should Be Advanceable

Most tax credits are provided to people after they file their annual income tax returns. However, some tax credits can instead be paid in advance based on a per-month estimate of the amount of the credit. Examples of such advanceable credits include the Health Care Tax Credit for those receiving Trade Readjustment Assistance, as well as early retirees receiving benefits from the Pension Benefit Guaranty Corporation. Since people and families usually pay their insurance premiums monthly, they need financial help as their premiums fall due, not many months—or more than a year—later.

## A Better Approach

If the goal is to help uninsured Americans obtain health insurance coverage, a better approach would be a plan such as the one unveiled recently by the Health Care Coverage for the Uninsured coalition (HCCU). This plan builds on existing public programs, which are better suited to serve people with low incomes. For people with somewhat higher incomes, the HCCU proposal includes a tax credit that is *both* refundable and advanceable.

For a further discussion of tax credit design issues, see *What Would a Good Tax Credit Look Like?* (January 18, 2007) at <http://www.familiesusa.org/issues/uninsured/hccu/whats-a-good-tax-credit-look.pdf>.

## Summary

The Bush tax deduction provides far too little relief to make health coverage affordable for the uninsured. It is regressive and provides no refundable or advanceable relief. As a result, it will provide little help to moderate-income uninsured families and is unlikely to noticeably reduce the number of uninsured Americans. The Bush tax deduction is far different from an advanceable, refundable health care tax credit that could, if properly designed, provide substantial help with the cost of health insurance coverage for moderate-income families.