EQUITY IN REFORMING THE TAX TREATMENT OF HEALTH INSURANCE PREMIUMS

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I. INTRODUCTION

In the area of health care reform, the tax treatment of health expenses continues to ignite controversy. Specifically, the tax treatment of health insurance premiums for individuals is one aspect of this reform perpetually under debate by Congress. Approximately 158 million nonelderly individuals in the United States receive health

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benefits from employers.[1] It is estimated that the exclusion for employer-provided health insurance has resulted in lost revenues to the federal government of $131 billion in 2008, and will result in $142 billion in lost revenues in 2009.[2] Recently, President Barack Obama and Democratic leaders in Congress have discussed the possibility of taxing employer-provided health insurance premiums to raise revenues to fund the President's health care reform.[3] Presidents George W. Bush and William J. Clinton, as well as many members of Congress and other individuals, had proposed different ways to reform the taxation of these premiums.[4]

Some reform has occurred in the taxation of health insurance premiums for self-employed individuals and a limited number of other individuals who purchase health insurance, but inequities in the tax system persist. Horizontal equity refers to similarly-situated individuals paying the same tax, whereas vertical equity occurs when individuals who have a greater ability to pay taxes actually pay more taxes.[5] This Article evaluates the inequities in current and proposed tax treatments of health insurance premiums,[6] and proposes a potential solution to

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[1] KAISER FAMILY FOUND. & HEALTH RESEARCH & EDUC. TRUST, EMPLOYER HEALTH BENEFITS: 2008 ANNUAL SURVEY 46 (2008) [hereinafter EMPLOYER HEALTH BENEFITS].

[2] OFFICE OF MGMT. & BUDGET, ANALYTICAL PERSPECTIVES, BUDGET OF THE U.S. GOVERNMENT, FISCAL YEAR 2010, at 301 (2009).

[3] Ceci Connolly, *President Pivots on Taxing Benefits; Obama is Willing to Consider Move to Gain Health Reform*, WASH. POST, June 3, 2009, at A03.

[4] *See, e.g.*, Paula Cruickshank, *Bush Promotes Health Care Agenda, Including Expanded MSAs and FSAs*, 2002 TAXDAY Item W.1 (CCH Feb. 12, 2002); Health Security Act, H.R. 3600, 103d Cong. (1993); Taxpayer Refund and Relief Act of 1999, H.R. 2488, 106th Cong. (1999); Healthy Americans Act, S. 391, 111th Cong. (2009); MARK V. PAULY ET AL., RESPONSIBLE NATIONAL HEALTH INSURANCE (1992).

[5] BORIS I. BITTKER & LAWRENCE LOKKEN, FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS ¶ 3.1.4 (1999).

[6] There are several aspects, in addition to equity, that should be considered when evaluating tax policy. Adam Smith proposed that certainty, convenience, and economy should be considered, and the American Institute of Certified Public Accountants also included simplicity, neutrality, economic growth and efficiency, transparency and visibility, minimum tax gap, and appropriate government revenues. Certainty occurs when a taxpayer knows when and how a tax is to be paid and when the taxpayer can ascertain the amount of tax to be paid. Convenience means that a tax is assessed when it is convenient for the taxpayer to pay it. For a tax system to be economical, it should have low compliance and administrative costs to allow the government to receive as much money as possible. ADAM SMITH, THE WEALTH OF NATIONS 429-32 (C.J. Bullock ed., Barnes & Noble 2004) (1776). Simplicity occurs when taxpayers understand the rules and can easily comply with them. For neutrality, tax laws should have a minimal effect on a taxpayer's transactional decisions. Under economic growth and efficiency, taxes should not negatively affect the economy.

eliminate such inequities.

Part II of this Article discusses the historical tax treatment of health insurance premiums. Part III describes the current tax treatment and analyzes its advantages and disadvantages. In Part IV, different proposed changes in the tax treatment of health insurance premiums are discussed, as well as the advantages and disadvantages of those proposals. Part V illustrates how the proposals fail to account for the inequity between single and family plans and sets forth a legislative alternative that rectifies this inequity. This alternative solution is a tax cap equivalent to the amount of the premiums paid for a single health insurance plan for employees, with the excess included in taxable income. Single individuals that pay for their own policies, including self-employed individuals, would be allowed to deduct from gross income the amount paid for a single health insurance plan or an equivalent amount if a family plan is purchased. Married individuals filing a joint return would be able to deduct an amount up to the value of two single plans. Finally, Part VI describes the proposed solution in terms of both equitable tax treatment and social policy.

II. EVOLUTION OF THE TAXATION OF HEALTH INSURANCE PREMIUMS

Although the tax treatment of health insurance premiums has changed over time, it has always been based on who pays for the premiums. In determining the proper tax treatment of these premiums, individuals covered by health insurance fall into three categories, including: (1) employees whose insurance premiums are paid by employers, (2) self-employed individuals, and (3) others who pay for their own insurance premiums.

A. Employees

Beginning in 1913, health insurance premiums paid by employers

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Transparency and visibility mean that taxpayers should know about the existence of a tax. Minimum tax gap means that noncompliance should be minimized. For appropriate government revenues, the government should be able to ascertain the amount of revenues that will be collected. TAX DIV., AM. INST. OF CERTIFIED PUB. ACCOUNTANTS, GUIDING PRINCIPLES OF GOOD TAX POLICY: A FRAMEWORK FOR EVALUATING TAX PROPOSALS 12-14 (2001). Although these are factors to be considered, the focus of this Article is the equitable treatment of health insurance premiums. Therefore, these factors will not be discussed at length.

on behalf of their employees were treated as nontaxable fringe benefits.[7] Therefore, employees could exclude from taxable income the amount of the premiums paid by the employer. If the cost of the premiums was more than what was paid by the employer, the employee had to pay the remainder of the cost from after-tax dollars.[8]

In 1943, the Internal Revenue Service (IRS) ruled that an employer's group health insurance plan's contributions were exempt from taxation for the employee.[9] However, in 1953, a revenue ruling stipulated that an employer's contributions to individual health insurance policies were taxable to the individual.[10] As a result, the premiums paid by the employer were deductible by the employer, but were included in the taxable income of employees.[11] Congress reversed the 1953 revenue ruling by enacting Section 106 of the Internal Revenue Code of 1954.[12] This section allowed employer-provided health insurance premiums to be excluded from an employee's taxable income.[13] There have been some changes to this section of the Code, such as amendments for provisions for Archer MSAs,[14] health savings accounts (HSAs),[15] and flexible spending accounts.[16] However, Section

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[7] CONG. BUDGET OFFICE, THE TAX TREATMENT OF EMPLOYMENT-BASED HEALTH INSURANCE 5 (1994) [hereinafter TAX TREATMENT].

[8] *Id.*; *see* CONG. BUDGET OFFICE, TAX SUBSIDIES FOR MEDICAL CARE: CURRENT POLICIES AND POSSIBLE ALTERNATIVES 6 (1980) [hereinafter TAX SUBSIDIES].

[9] TAX TREATMENT, *supra* note 7, at 5.

[10] Rev. Rul. 210, 1953-2 C.B. 114.

[11] TAX SUBSIDIES, *supra* note 8, at 5.

[12] I.R.C. § 106 (1954) ("IN GENERAL. – Gross income does not include contributions by the employer to accident or health plans for compensation (through insurance or otherwise) to his employees for personal injuries or sickness."). *See* TAX TREATMENT, *supra* note 7.

[13] TAX TREATMENT, *supra* note 7.

[14] Health Insurance Portability and Accountability Act of 1996, Pub. L. No. 104-191, § 301(c)(1), 110 Stat. 1936 (1996) (codified as amended at I.R.C. § 106(b)). Archer MSAs are medical savings accounts that individuals may use to pay for unreimbursed medical expenses, as described in I.R.C. § 220. Contributions by employers are not taxable to the employees under Section 106(b). In addition, individual contributions are deductible from gross income if an employer does not contribute to an MSA. I.R.C. §§ 62(a)(16), 220(a). When an individual withdraws from an MSA for unreimbursed medical expenses, the withdrawal is not taxed to the individual. I.R.C. § 220(f)(1). *See* BOB LYKE & CHRIS L. PETERSON, CONG. RESEARCH SERV., FLEXIBLE SPENDING ACCOUNTS AND MEDICAL SAVINGS ACCOUNTS: A COMPARISON, Rep. No. 96-500 EPW (Jul. 21, 2003), (describing the characteristics of MSAs).

[15] Medicare Prescription Drug, Improvement, and Modernization Act of 2003, Pub. L. No. 108-173 § 1201(d)(1), 117 Stat. 2066 (2003) (codified as amended at I.R.C. § 106(d)). The updated, less restrictive, version of the MSA is the HSA, in which contributions may be

106(a) and the tax treatment of employer-provided insurance premiums have remained mostly unchanged since 1954.

B. Self-Employed

The tax treatment of premiums paid by self-employed individuals has changed over time. Self-employed individuals include: sole proprietors, general partners, limited partners who receive guaranteed payments from the partnership, and individuals who own more than two percent of an S-corporation and receive wages from that S-corporation.[17] Originally, self-employed individuals could not deduct the health insurance premiums they paid for themselves as a business expense under I.R.C. § 162. However, they could deduct the cost of premiums for insurance that they provided for their employees as a business expense. Therefore, to deduct premiums for their own insurance, some self-employed individuals employed their spouses and purchased insurance for them.[18]

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made by employers, individuals, or both. BOB LYKE & JULIE M. WHITTAKER, CONG. RESEARCH SERV., TAX BENEFITS FOR HEALTH INSURANCE AND EXPENSES: OVERVIEW OF CURRENT LAW AND LEGISLATION, Rep. No. RL33505 (Feb. 5, 2008). Individuals with a qualifying high-deductible health plan may establish and fund these accounts, which carry a relatively high out-of-pocket limit. *Id.* Contributions to HSAs are deductible, and earnings are not included in gross income. STAFF OF J. COMM. ON TAXATION, 109TH CONG., PRESENT LAW AND ANALYSIS RELATING TO THE TAX TREATMENT OF HEALTH SAVINGS ACCOUNTS AND OTHER HEALTH EXPENSES 9 (Comm. Print 2006). Recent data indicates that the number of HSAs appears to be growing, and the Tax Relief and Health Care Act of 2006, Pub. L. No. 109-432, Title III, § 301, 120 Stat. 2948 (2006), expanded the rules pertaining to HSAs to increase their attractiveness. For example, an individual may transfer funds from a flexible spending account to an HSA one time, but the amount that can be distributed is limited. Stanley D. Baum, *Congress Makes Health Savings Accounts More Attractive to Employers, Employees*, 106 J. TAX'N 159, 162 (2007). Proponents of HSAs argue that they would provide incentives for individuals to more closely monitor their health care costs, thus resulting in a more efficient use of health care resources and lower health insurance premiums. Katherine Baicker, William H. Dow, & Jonathan Wolfson, *Health Savings Accounts: Implications for Health Spending*, 59 NAT'L TAX J. 463, 474 (2006).

[16] Health Insurance Portability and Accountability Act of 1996, Pub. L. No. 104-191, § 321(c)(2), 110 Stat. 1936 (1996) (codified as amended at I.R.C. § 106(c)). Flexible spending accounts are benefit plans established by employers in which employees are reimbursed for specific expenses when they are incurred. Employees usually contribute part of their salaries or wages to their accounts. Any amount that is not used by an employee at the end of the year is given back to the employer. Contributions by employees to flexible spending accounts are not subject to income and employment taxes. LYKE & PETERSON, *supra* note 14.

[17] BOB LYKE & CHRISTOPHER SROKA, CONG. RESEARCH SERV., TAX BENEFITS FOR HEALTH INSURANCE: CURRENT LEGISLATION, Rep. No. IB98037 (Feb. 15, 2002).

[18] Phillip Harrington, *Small Firms Get Help from Section 105*, NAT'L UNDERWRITER,

At various times, Congress increased the amount of insurance premiums that self-employed individuals may deduct under I.R.C. § 162(l).[19] In 1998, Congress passed the Tax and Trade Relief Extension Act, which increased the deduction for self-employed individuals.[20] Self-employed individuals were allowed to deduct sixty percent of their health insurance premiums from gross income in 2001, seventy percent of health insurance premiums from gross income in 2002, and 100 percent of health insurance premiums from gross income in 2003 and the years thereafter.[21] The purpose of this change in the tax law was to reduce the disparity of the tax treatment between self-employed individuals and employees with employer-provided health insurance.[22] This change also made health insurance more affordable for those who were self-employed.[23]

C. Others

The category "others" includes employees and other individuals who pay for their own premiums. The Revenue Act of 1942 first allowed this group to deduct the cost of insurance premiums as medical expenses.[24] They could deduct these expenses as an itemized deduction if the expenses exceeded five percent of net income,[25] calculated

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Jul. 7, 1997, at 10.

[19] *See generally* Deduction for Health Insurance Costs of Self-Employed Individuals, Pub. L. No. 104-7, § 1(b), 109 Stat. 93, 93 (1995) (amending I.R.C. § 162(*l*)(1) to increase the percentage of paid premiums that self-employed individuals are allowed to deduct from twenty-five percent to thirty percent); Health Insurance Portability and Accountability Act of 1996, Pub. L. No. 104-191, § 311(a), 110 Stat. 1936, 2053 (1996) (increasing the percentage deductible in I.R.C. § 162(*l*)(1)(B) to forty percent in 1997, forty-five percent for years 1998 through 2002, fifty percent in 2003, sixty percent in 2004, seventy percent in 2005, and eighty percent for 2006 and thereafter); Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 934(a), 111 Stat. 788, 882 (1997) (increasing the percentage deductible in I.R.C. § 162(*l*)(1)(B) to fifty percent in 2000 and 2001, sixty percent in 2002, eighty percent 2003 through 2005, ninety percent in 2006, and 100 percent in 2007 and thereafter); Tax and Trade Relief Extension Act of 1998, Pub. L. No. 105-277, § 2002(a), 112 Stat. 2681, 2681-901 (1998) (increasing the percentage deductible in I.R.C. § 162(*l*)(1)(B) to sixty percent for years 1999 through 2001, seventy percent for 2002, and 100 percent for years 2003 and thereafter).

[20] Tax and Trade Relief Extension Act of 1998, Pub. L. No. 105-277, § 1000, 112 Stat. 2681 (1998).

[21] *Id.* § 2002 (codified as amended at I.R.C. § 162(*l*)(1)(B)).

[22] H.R. REP. NO. 105-739, at 48 (1998).

[23] *Id.*

[24] Revenue Act of 1942, Pub. L. 77-753, § 127, 56 Stat. 798 (1942).

[25] Net income is defined as "[t]otal income from all sources minus deductions,

exclusive of medical expenses.[26] In 1944, the rate was changed to five percent of adjusted gross income[27] instead of net income.[28] The percentage floor has both decreased and increased over time.[29] Under the Tax Reform Act of 1986, the floor for deducting medical expenses was increased to 7.5 percent of adjusted gross income.[30] Since it was reducing tax rates by broadening the base of gross income, Congress believed it was acceptable to increase the floor to determine the medical expense deduction.[31]

The Trade Adjustment Assistance Reform Act of 2002[32] created the Health Coverage Tax Credit under I.R.C. § 35, a refundable credit to assist certain displaced workers and retirees in paying for health insurance.[33] Under the Act, certain individuals were allowed to claim a tax credit equal to sixty-five percent of the amount paid for premiums.[34] The American Recovery and Reinvestment Act of 2009 increased this credit to eighty percent of the amount claimed for months prior to 2011,[35] with the credit reverting back to sixty-five percent in 2011. To claim the credit, individuals must be eligible, be covered by qualified health insurance paid for by the taxpayer, not have other specified coverage, and not be imprisoned.[36] To be eligible, taxpayers must be

exemptions, and other tax reductions." BLACK'S LAW DICTIONARY 831 (9th ed. 2009). It is the dollar amount used to calculate income tax liability. *Id.*

[26] Revenue Act of 1942, Pub. L. 77-753, § 127, 56 Stat. 798 (1942).

[27] Adjusted gross income is defined as gross income less trade and business deductions, losses from the sale or exchange of property, and other certain deductions as defined in the Internal Revenue Code. I.R.C. § 62(a). Gross income is defined as all income from whatever source derived. I.R.C. § 61(a). For individuals, the standard or itemized deduction, personal exemptions, and dependency exemptions are subtracted from adjusted gross income to arrive at taxable income (or net income). I.R.C. § 63.

[28] Individual Income Tax Act of 1944, Pub. L. No. 78-315, § 8, 58 Stat. 231 (1944).

[29] *See* 8 JACOB MERTENS, LAW OF FEDERAL INCOME TAXATION § 31B:2 (2009). For example, in 1954, Congress reduced the floor to three percent. It was later increased back to five percent, and then to its current rate of 7.5 percent. *Id. See generally* TAX SUBSIDIES, *supra* note 8, at 25-26 (giving a general overview of how the rates and ceilings for the medical expense deduction had changed over time).

[30] Tax Reform Act of 1986, Pub. L. No. 99-514, § 133, 100 Stat. 2116 (1986) (codified as amended at I.R.C. § 213(a)).

[31] MERTENS, *supra* note 29, at § 31B:2.

[32] Pub. L. No. 107-210, § 201(a), 116 Stat. 933 (2002).

[33] INTERNAL REVENUE SERV., HEALTH COVERAGE TAX CREDIT, http://www.irs.gov/newsroom/article/0,,id=112024,00.html (last visited October 3, 2009).

[34] Pub. L. No. 107-210, § 201(a), 116 Stat. 933 (2002).

[35] Pub. L. No. 111-5, § 1899A, 123 Stat. 423 (2009).

[36] I.R.C. § 35(b)(1)(A).

eligible Trade Adjustment Assistance (TAA) recipients,[37] eligible alternative TAA recipients,[38] or eligible Pension Benefit Guaranty Corporation (PBGC) pension recipients.[39]

III. TAXATION OF HEALTH INSURANCE PREMIUMS TODAY

Under I.R.C. § 106(a), an employee can exclude the cost of health insurance premiums from gross income.[40] Treasury Regulation § 1.106-1 expands on this section of the Code by stating that an employee should not treat contributions by an employer to accident or health plans as compensation.[41] This regulation excludes from gross income the payment by an employer for premiums or contributions to a separate trust or fund that provides health benefits to employees.[42] An employer may deduct from gross income the cost of the health insurance that it provides to its employees as a business expense under I.R.C. § 162.[43] Under Section 162(l)(1)(B), self-employed individuals may deduct 100 percent of the cost of health insurance premiums that they purchase for themselves, their spouses, and their dependents for the taxable years beginning in 2003 and thereafter.[44] Qualified individuals who pay for health insurance may receive a tax credit in the amount of eighty percent of the premiums for which they paid under I.R.C. § 35(a), and

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[37] The Trade Adjustment Assistance (TAA) program was created to assist workers who suffer from job loss or reduced work or wages, and provides benefits and services for those workers to find new employment. INTERNAL REVENUE SERV., HCTC: TAA, ATAA & RTAA RECIPIENTS, http://www.irs.gov/individuals/article/0,,id=185763,00.html (last visited August 17, 2009). An eligible TAA recipient is defined as an individual who receives a trade readjustment allowance or would be eligible to receive the allowance if the individual had not exhausted all rights to unemployment insurance. *Id.*

[38] The Alternative Trade Adjustment Assistance is a benefit that provides wage subsidies to workers that have hard-to-transfer skills. *Id.* An eligible alternative TAA recipient is defined as a worker who is at least 50 years old, lost a job and acquired a new job that pays lower wages, and receives wage supplements from a state. *Id.*

[39] The PBGC provides insurance for pension benefits. INTERNAL REVENUE SERV., HCTC: PBGC RECIPIENTS, http://www.irs.gov/individuals/article/0,,id=185767,00.html (last visited October 3, 2009). An eligible PBGC pension recipient is defined as an individual who is at least 55 and is receiving a benefit paid by the PBGC. I.R.C. § 35(c)(4).

[40] I.R.C. § 106(a) ("GENERAL RULE.–Except as otherwise provided in this section, gross income of an employee does not include employer-provided coverage under an accident or health plan.").

[41] Treas. Reg. § 1.106-1 (1956).

[42] *Id.*

[43] Treas. Reg. § 1.162-10(a) (1958).

[44] *See supra* text accompanying notes 20-23.

this amount will be reduced to sixty-five percent in 2011.[45] All other individuals who pay for their health insurance premiums can deduct only the cost of the premium as an itemized deduction under I.R.C. § 213(a), which is limited to an amount greater than 7.5 percent of adjusted gross income.[46]

The current tax system of excluding health insurance premiums from taxable income has several advantages. For example, because of the exclusion, more individuals would be insured. It is estimated that more than sixty percent of the population in the United States who are under the age of sixty-five and not institutionalized are insured by an employment-based plan.[47] Employers have an incentive to sponsor health insurance plans because the expense is deductible.[48] Employees have an incentive to accept health insurance as compensation because the premiums are not taxed. Furthermore, employment-based group policies are less expensive than individual policies because large employers can pool the risk of many employees.[49] Tax accounting is simplified because employers do not need to report information about the health insurance provided to each individual employee.[50] There is less paperwork for the employer, and the IRS does not have to process the information. In addition, costs to the government decrease when individuals participate in private health insurance plans because the expenses paid by government medical programs, such as Medicaid, are reduced.[51]

The current system also has some disadvantages. One shortcoming is that employers and employees are encouraged to choose expensive

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[45] *See supra* text accompanying notes 32-39.

[46] I.R.C. §§ 213(a), (d). *See supra* text accompanying notes 24-31. Representatives Phillip M. Crane, Sam Johnson, and Pete Sessions introduced the Medical Cost Deduction Act of 2002, H.R. 4001, 107th Cong. (2002). If enacted, this Act reduces the floor for the medical expense deduction from 7.5 percent to two percent of adjusted gross income. This Act allowed for individuals to deduct a greater amount of insurance premiums paid as itemized deductions. For individuals to use the deduction, they still had to meet the requirements to itemize their deductions, and may not be able to use such deductions. Therefore, this type of proposal will not be discussed as an option to eliminate the inequalities of the tax treatment of health insurance premiums in this Article.

[47] LYKE & WHITTAKER, *supra* note 15.

[48] *See* TAX TREATMENT, *supra* note 7, at xii.

[49] *Id.*

[50] *Id.*

[51] Bradley W. Joondeph, *Tax Policy and Health Care Reform: Rethinking the Tax Treatment of Employer-Sponsored Health Insurance*, 1995 BYU L. REV. 1229, 1236 (1995).

health insurance policies,[52] partly because it is deductible by employers and excluded from employees' gross income. Another disadvantage is that the current system creates what is called "job lock," which is when an employee stays at a job solely to retain health insurance.[53] This restricts the mobility of workers because some will not want to change jobs if they will not be covered by a new employer's health insurance as a result of preexisting conditions.[54]

The main disadvantage, and the focus of this Article, is that the tax treatment of health insurance premiums is unfair to some individuals. Employees can exclude, and employers can deduct, the full amount of insurance premiums. In addition, self-employed individuals are able to deduct the total amount of premiums paid. However, most individuals who pay for their own health insurance premiums are not able to deduct the full cost of the premiums. A select group of individuals who purchase their own insurance are able to claim the Health Coverage Tax Credit, and may deduct eighty percent—sixty-five percent beginning in 2011—of the amount paid for health insurance.[55] Individuals who pay for their own health insurance premiums and are not eligible for the Health Coverage Tax Credit are allowed to deduct only the amount over 7.5 percent of gross income if they itemize their deductions. This deduction is not widely used by individuals. The standard deduction is usually larger than the total amount of itemized deductions for individuals, and even if an individual itemizes deductions, the total amount of medical expenses usually do not exceed the 7.5 percent floor.[56] It was estimated that in 2006, only thirty-five percent of individual taxpayers itemized their deductions.[57] Among those who itemized, twenty-one percent of the taxpayers had unreimbursed medical expenses that exceeded the 7.5 percent floor.[58] As a result, about seven percent of all individual taxpayers in 2006 were able to claim a medical expense deduction.[59]

The current tax system violates the principle of horizontal equity.

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[52] *Id.* at 1243-45.

[53] *Id.* at 1248.

[54] TAX TREATMENT, *supra* note 7, at 22.

[55] I.R.C. § 35.

[56] LYKE & SROKA, *supra* note 17.

[57] Justin Bryan, *Individual Income Tax Returns, 2006,* 28 STAT. OF INCOME BULL., Fall 2008, at 5, 52-53, *available at* http://www.irs.gov/pub/irs-soi/08fallbul.pdf.

[58] *Id.*

[59] *Id.*

Individuals who receive health insurance through their employers pay less tax than those who do not receive the insurance but who are similarly situated.[60] Employees who receive more expensive policies obtain more benefits than those who have less expensive policies.[61] If an employer pays for a greater portion of the cost of premiums, those employees receive more of a benefit than employees whose employer does not pay as much for premiums.[62] In addition, individuals who do not receive any insurance from an employer do not receive any benefit from the exclusion.[63]

The current tax system also violates the principle of vertical equity. Employees who have higher incomes are more likely to receive health insurance from their employers than employees with lower incomes.[64] If all individuals are able to exclude the cost of insurance premiums from taxable income, the benefits are greater for those in a higher income tax bracket.[65] For example, if an individual's marginal tax rate is fifteen percent, the individual will save $600 in income tax if the excludable health insurance premiums are $4,000.66 However, if the individual's marginal tax rate is thirty-six percent, the individual will save $1,440 if the excluded premiums are $4,000.[67] Therefore, individuals with higher incomes actually benefit more from the current tax system.

IV. PROPOSALS FOR CHANGE

There have been many proposals to change the tax treatment of health insurance premiums for individuals. These proposals include: tax credits, deductions from gross income, capping the exclusion, and repealing the exclusion. Generally, tax credits allow taxpayers to deduct health insurance premiums from the amount of taxes owed. Deductions from gross income allow taxpayers to deduct the amount of the premiums directly from gross income. However, tax caps allow taxpayers to exclude only a maximum amount of premiums from gross

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[60] TAX TREATMENT, *supra* note 7, at 29.

[61] *Id.*

[62] *Id.*

[63] *Id.*

[64] CONG. BUDGET OFFICE, ECONOMIC IMPLICATIONS OF RISING HEALTH CARE COSTS 31 (1992).

[65] INST. OF MED., EMPLOYMENT AND HEALTH BENEFITS: A CONNECTION AT RISK 111 (Marilyn J. Field & Harold T. Shapiro eds., National Academy Press 1993).

[66] LYKE & SROKA, *supra* note 17.

[67] *Id.*

income. If the exclusion is repealed, premiums paid by employers would be included in employees' gross income. These proposals are discussed in this section.

A. Tax Credits

There have been many proposals that would provide tax credits for health insurance premiums.[68] Under tax credit schemes, credits allow individuals to reduce their tax liabilities by deducting the cost of premiums directly from their tax liabilities. For example, if an individual pays $1,000 for insurance premiums and has a $1,500 tax liability for the year, the individual owes only $500—$1,500 less $1,000—in taxes. In addition, credits may be refundable or advanceable. Refundable tax credits allow taxpayers to receive refunds if the amounts of the credits are greater than their income tax liabilities.[69] This allows taxpayers not only to pay no taxes, but also to receive money from the government.[70] For example, an individual who has a $400 tax liability and paid $1,000 for insurance premiums owes no income taxes for the year and receives $600 from the federal government for the remaining amount of the insurance premiums. Advanceable tax credits allow individuals to use the credits when they purchase insurance rather than when they file tax returns, which would reduce the cost of the premiums at the time the insurance is purchased.[71]

Mark V. Pauly, Patricia Danzon, Paul J. Feldstein, and John Hoff proposed a form of national health insurance in the early 1990s,[72] which would eliminate the health insurance premium exclusion. Employees

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[68] *See generally* Consumer Choice Health Security Act, S. 1743, 103d Cong. (1993) (allowing for a refundable tax credit for lower-income families); Fair Care for the Uninsured Act, H.R. 2362, 106th Cong. (1999) (allowing taxpayers to take a refundable tax credit against income tax for the purchase of health insurance); Health Insurance Affordability and Equity Act, H.R. 2261, 106th Cong. (1999) (allowing tax credits for up to sixty percent of health insurance paid for taxpayers who pay for more than fifty percent of the insurance premiums).

[69] OFFICE OF PUB. AFFAIRS, DEP'T OF THE TREASURY, JOINT TESTIMONY OF MARK MCCLELLAN, MEMBER, COUNCIL OF ECONOMIC JOINT ADVISERS AND MARK WEINBERGER, ASSISTANT SECRETARY OF THE TREASURY (TAX POLICY) UNITED STATES DEPARTMENT OF THE TREASURY BEFORE THE HOUSE WAYS AND MEANS COMMITTEE ON HEALTH INSURANCE TAX CREDITS, PO-1013, Feb 13, 2002, *available at* http://www.treas.gov/press/releases/po1013.htm (last visited June 15, 2009).

[70] *Id.*

[71] *Id.*

[72] *See* PAULY ET AL., *supra* note 4 (giving more detail on this national health care proposal).

would include in taxable income the amount of the premiums paid by an employer, and their taxes would then be reduced by credits.[73] The credits would be used to determine the deduction for self-employed individuals.[74] Individuals who are not employed would receive tax credits for insurance they purchase. For low-income families, the credits would be refundable.[75] The credits would be reduced for individuals with higher incomes, which could make the credits less than the cost of the insurance premiums. As a result, individuals with higher incomes would have to pay for part of the premiums themselves.[76]

Also in the early 1990s, the Heritage Plan was proposed by Stuart Butler of the Heritage Foundation.[77] Under this plan, employees would include the value of health insurance premiums paid by employers in gross income.[78] Individuals who do not receive employer-provided health insurance would be required to purchase insurance for themselves.[79] All individuals would then be able to take tax credits for health insurance purchased.[80] The credits would range from twenty percent for those with high incomes to ninety percent for those with low incomes.[81]

During his first term in office, President George W. Bush proposed tax credits for individuals who do not receive employer-provided health insurance.[82] President Bush's tax credit would have been both refundable and advanceable.[83] Under the proposal, the highest percentage that the credit allowed is ninety percent of premiums paid for by an individual.[84] The credit allowed up to $1,000 for individuals and $3,000 for families.[85] However, the credit phased out for higher

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[73] *Id.* at 17.
[74] *Id.* at 23.
[75] *Id.* at 24.
[76] *Id.* at 16.
[77] David Frum, *What to Do About Health Care*, COMMENTARY MAGAZINE, June 1995, at 29, 32.
[78] *Id.*
[79] *Id.*
[80] *Id.*
[81] *Id.*
[82] *See* Cruickshank, *supra* note 4.
[83] COUNCIL OF ECON. ADVISERS, HEALTH INSURANCE CREDITS 1 (Feb. 14, 2002), http://georgewbush-whitehouse.archives.gov/cea/HealthCredit_Feb02wp.pdf (last visited October 3, 2009).
[84] *Id.*
[85] *Id.*

incomes, beginning at $15,000 for single taxpayers and $25,000 for those filing under a different status.[86] Individuals with over $30,000 of income and families with over $60,000 of income were not eligible to receive a tax credit for insurance premiums.[87]

During the 2008 presidential campaign, Senator John McCain proposed tax credits for all individuals. This proposal would replace the exclusion for employer-provided health insurance with a tax credit of $2,500 for individuals and $5,000 for families.[88] In addition, the credit applied regardless of the cost of the insurance premiums and was refundable.[89]

The Patients' Choice Act of 2009 was put forth by Senators Tom Coburn and Richard Burr,[90] as well as Representatives Paul Ryan and Devin Nunes.[91] The proposed changes in the Act replace the employer-provided health insurance exclusion with a universal tax credit,[92] which is similar to Senator McCain's proposal. As with President Bush's proposal, these credits would be refundable and advanceable.[93] As a result, they could be used to invest in personal, tax-free HSAs.[94] Specifically, taxpayers would receive individual tax rebates, worth $2,290 for individuals and $5,710 for families, to purchase health insurance.[95]

There are several advantages to permitting tax credits for health insurance premiums. One advantage is that it would reduce incentives for employees to obtain comprehensive health insurance if the credits were limited, which could help reduce the cost of health care.[96] Another advantage is that credits would allow more individuals to become insured—an estimated six million more Americans than under President

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[86] *Id.*

[87] *Id.* at 6.

[88] LINDA J. BLUMBERG & JOHN HOLAHAN, THE URBAN INSTITUTE HEALTH POLICY CENTER, AN ANALYSIS OF THE MCCAIN HEALTH CARE PROPOSAL 1 (2008), *available at* http://www.urban.org/UploadedPDF/411755_mccain_health_proposal.pdf.

[89] *Id.*

[90] Patients' Choice Act, S. 1099, 111th Cong. (2009).

[91] Patients' Choice Act, H.R. 2520, 111th Cong. (2009).

[92] *The Patient's Choice Act of 2009 is a Chance for Reform*, TULSA BEACON (May 28, 2009), *available at* http://www.tulsabeacon.com/?p=2110.

[93] Grace-Marie Turner & Joseph R. Antos, *The GOP's Health-Care Alternative*, WALL ST. J., May 20, 2009, at A17.

[94] *Id.*

[95] S. 1099.

[96] *See* TAX SUBSIDIES, *supra* note 8, at 17.

Bush's proposal.[97] Third, tax credits would allow for those individuals who do not have employer-provided health insurance to receive a reduction in taxes even if they do not itemize deductions.

There are also several disadvantages to tax credits. One is that tax credits do not guarantee that insurance companies will accept individuals who have preexisting medical conditions.[98] A second disadvantage is that under some tax credit proposals, low-income families still may not be able to afford health insurance. Some families may have to spend over half of their income to be covered by health insurance.[99] Another disadvantage is that individuals would be required to pay health insurance premiums before they receive their credits.[100] This problem could be reduced by advanceable tax credits.[101] However, there may be uncertainty in the total amount of the credits, which may discourage low-income individuals from purchasing health insurance using advanced credits.[102] Tax credits may have a fourth disadvantage of causing employers to stop providing health insurance for employees.[103] Employers may decide that it may be better for employees to receive the government-provided credits for insurance instead of providing insurance for their employees.

In addition to the above disadvantages, the tax credit proposals are not equitable. Many of the proposals base the tax credits on an individual's income and are eventually phased out. As a result, individuals with higher incomes do not receive any tax benefits from having health insurance. Also, under some plans, individuals who receive employer-provided health insurance would still be able to exclude the amount of the premiums from gross income. This would not eliminate the problem with inequities because individuals would not pay the same amount of taxes as other similarly situated individuals.

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97 COUNCIL OF ECON. ADVISERS, *supra* note 83, at 1.

98 Paula Cruickshank & Dave Hansen, *House Committee Debates Health Care Tax Credits*, 2002 TAXDAY Item C.3 (CCH Feb. 14, 2002).

99 JACK REED, SENATOR, J. ECON. COMM. DEMOCRATIC STAFF, HEALTH INSURANCE CREDITS: THE WRONG PRESCRIPTION FOR THE UNINSURED (Feb. 13, 2002), *reprinted in Health Care Tax Credits to Decrease the Number of Uninsured: Hearing before the House Comm. on Ways and Means*, 107th Cong. 12 (2002).

100 URBAN INST., SOCIAL POLICY AND THE TAX SYSTEM 15 (2002), *available at* http://www.urban.org/UploadedPDF/310418_TaxSystem.pdf [hereinafter SOCIAL POLICY].

101 *Id.*

102 Linda J. Blumberg, *Health Insurance Tax Credits: Potential for Expanding Coverage*, HEALTH POL'Y BRIEFS, 5 (Aug. 2001); *see also* SOCIAL POLICY, *supra* note 100.

103 SOCIAL POLICY, *supra* note 100.

B. Deductions from Gross Income

Instead of directly reducing an individual's taxes with a credit, an individual could be allowed to deduct the amount paid for insurance premiums from gross income. This treatment would be similar to that currently used by self-employed individuals. In 1999, two proposals in Congress proposed deductions for health insurance premiums. One proposal was the Taxpayer Refund and Relief Act of 1999,[104] which was introduced by Representative Bill Archer. The second proposal was the Quality Care for the Uninsured Act of 1999,[105] which was introduced by Representative James M. Talent. Under both proposals, individuals were allowed to take a 100 percent deduction from gross income for health insurance premiums as long as the taxpayer paid more than fifty percent of the premiums.[106]

During his second term in office, President George W. Bush proposed a tax deduction for health insurance premiums. Under this proposal, insured taxpayers could deduct $7,500 for single policies, or $15,000 for family policies, regardless of the cost of the health insurance premiums.[107] The proposal would repeal the exclusion for health insurance provided by employers under Section 106(a), but employees who receive such benefits would be able to deduct the amounts in the proposal from gross income.[108] To receive the deduction, individuals must be covered by qualifying health care coverage that satisfies certain minimum requirements, which include limits on out-of-pocket exposure for covered expenses, a reasonable annual or lifetime benefit maximum, coverage for inpatient and outpatient care, emergency benefit coverage, physician care coverage, and guaranteed renewability by the insurance provider.[109]

A recent proposal that includes comprehensive health insurance is the Healthy Americans Act, which was originally proposed by Senators Ron Wyden and Robert Bennett in 2007.[110] Under this health care

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104 H.R. 2488, 106th Cong. (1999).

105 H.R. 2990, 106th Cong. (1999).

106 CCH Wash. News Bureau, *Wash. Report*, 1999 TAX WKLY. No. 40, Oct. 14, 1999.

107 LYKE & WHITTAKER, *supra* note 15; STAFF OF J. COMM. ON TAXATION, 110TH CONG., ESTIMATING THE REVENUE EFFECTS OF THE ADMINISTRATION'S FISCAL YEAR 2008 PROPOSAL PROVIDING A STANDARD DEDUCTION FOR HEALTH INSURANCE: MODELING AND ASSUMPTIONS 3 (Comm. Print 2007) [hereinafter ESTIMATING THE REVENUE EFFECTS].

108 LYKE & WHITTAKER, *supra* note 15.

109 ESTIMATING THE REVENUE EFFECTS, *supra* note 107, at 4.

110 Healthy Americans Act, S. 334, 110th Cong. (2007).

legislation, individuals would be required to purchase private health insurance with state-based purchase pools and premiums collected through the federal government serving as the purchasing mechanism.[111] In terms of changes to the current tax code, the Act would provide a standard deduction for health insurance that would be phased out for higher income taxpayers and would eliminate the exclusion for employer-provided health insurance.[112] Premium payments would be considered part of an individual's tax liability, and the deduction would reduce the individual's adjusted gross income.[113] The Healthy Americans Act was reintroduced in 2009,[114] and under the current bill in the Senate, the maximum deduction amounts range from $6,025 for individuals to $15,210—plus an additional $2,000 for each dependent child beyond the first child—for families.[115]

Representative Cliff Stearns introduced the Health Care Tax Deduction Act of 2009.[116] This Act allows taxpayers to deduct the cost of health insurance premiums paid in full for themselves, their spouses, and their dependents even if they do not itemize deductions.[117] Also in 2009, Senator Barbara Boxer proposed the Health Insurance Tax Relief Act,[118] which would amend I.R.C. § 213 to allow taxpayers to deduct health insurance premiums from income without the 7.5 percent limitation for itemized medical deductions.[119] However, the deduction would be limited to $4,000 for taxpayers who file a joint return and

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[111] Letter from Peter R. Orszag, Dir., Cong. Budget Office, & Edward D. Kleinbard, Chief of Staff, J. Comm. on Taxation, to Honorable Ron Wyden, U.S. Senate, & Honorable Robert F. Bennett, U.S. Senate (May 1, 2008), *available at* http://cbo.gov/ftpdocs/91xx/doc9184/05-01-HealthCare-Letter.pdf [hereinafter Letter from Orszag & Kleinbard].

[112] THE HENRY J. KAISER FAMILY FOUND., SIDE-BY-SIDE COMPARISON OF MAJOR HEALTH CARE REFORM PROPOSALS 10 (2009), *available at* http://www.kff.org/healthreform/sidebyside.cfm (last modified Sept. 23, 2009).

[113] Letter from Orszag & Kleinbard, *supra* note 111.

[114] S. 391, 111th Cong. (2009).

[115] *Id.* § 664(a).

[116] H.R. 198, 111th Cong. (2009). Representative Stearns had introduced similar bills in the past, such as the Health Care Tax Deduction Act of 2001, H.R. 1127, 107th Cong. (2001); the Health Care Tax Deduction Act of 2003, H.R. 198, 108th Cong. (2003); the Health Care Tax Deduction Act of 2005, H.R. 218, 109th Cong. (2005); and the Health Care Tax Deduction Act of 2007, H.R. 227, 110th Cong. (2007).

[117] H.R. 198, 111th Cong. § 2(a)-(b) (2009).

[118] S. 207, 111th Cong. (2009).

[119] *Id.* § 2(a).

$2,000 for all other taxpayers.[120] In addition, the deduction would be reduced by five percent of the amount of adjusted gross income that exceeds $150,000 for those who file jointly or $75,000 for all others.[121]

An advantage of allowing deductions from gross income is that deductions are more equitable than tax credits, which directly reduce tax liability. If an individual who pays the premiums is allowed to deduct the amount from gross income, the treatment would be similar to the exclusion from gross income by an employee who receives employer-provided health insurance and the 100 percent deduction for premiums paid by self-employed individuals.

There are several disadvantages of allowing deductions from gross income. One disadvantage is that the proposals may not be equitable to all taxpayers. The Taxpayer Refund and Relief Act of 1999 and the Quality Care for the Uninsured Act of 1999 allow for individuals to take the deduction from gross income only if they pay for more than fifty percent of the premiums.[122] This is not fair to those individuals who do not pay for at least fifty percent of the premiums. They are not allowed to take any deduction for the additional amount paid, while employees who do not pay for any of the premiums for insurance received from employers are able to exclude the entire amount from gross income.[123] The Healthy Americans Act and the Health Insurance Tax Relief Act limit the maximum amount of the deduction allowed.[124] This would not be equitable for those taxpayers who must pay more than the maximum deduction allowed for health insurance. Also, President Bush's proposal allows for a deduction regardless of the cost of premiums to taxpayers.[125] Taxpayers who do not pay $7,500 for single coverage or $15,000 for family coverage would be able to receive an extra deduction, while those who pay more than the maximum deduction would not receive as much of a benefit.[126] A second disadvantage is that, like tax credits, a deduction does not guarantee that insurance companies will accept individuals with preexisting conditions. A third disadvantage is that a deduction from gross income benefits high-

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[120] *Id.*
[121] *Id.*
[122] *See supra* text accompanying notes 104-106.
[123] *See supra* text accompanying note 106.
[124] *See supra* text accompanying notes 110-115 and 118-121.
[125] *See supra* text accompanying notes 107-109.
[126] *See supra* text accompanying note 107.

income taxpayers more than low-income taxpayers.[127] For example, a low-income taxpayer may not have any tax liability for the year.[128] If that taxpayer is only allowed to reduce gross income, the taxpayer does not receive any tax benefit for purchasing health insurance.[129] Finally, insurance premiums must be paid before individuals can receive the benefits of the deduction, which may be a problem for those who do not have the cash available to purchase health insurance.

C. Tax Caps

Under a cap on the exclusion of premiums, an employee is allowed to exclude from gross income the amount paid for insurance up to a maximum amount. The amount paid for the premiums above the excluded amount is included in the employee's gross income.[130] A cap may also allow all other individuals to deduct payments of insurance premiums up to a maximum amount.[131] The maximum amount could include the value equal to a basic insurance package, but could be increased to include dental and chiropractic coverage.

In 1993, President William J. Clinton proposed the Health Security Act,[132] which proposed to create a national health care system.[133] Under the Act, employers were required to pay for insurance for their employees who worked at least 40 hours each month.[134] Employees would exclude the cost of the health insurance if the plans provided a standard benefit package, and employers would be able to deduct only an amount up to the cost of a standard benefit package.[135] If employers paid any amount above the rates for a standard benefit package, that amount would be included in the employees' taxable incomes, and the employers would not be able to deduct the excess cost.[136] The proposed

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[127] Lawrence J. Holbrook, *Treasury Benefits Official Discusses Tax Policy for the Uninsured*, 2001 TAXDAY Item T.1 (CCH Oct. 26, 2001).

[128] *Id.*

[129] *Id.*

[130] TAX TREATMENT, *supra* note 7, at 33.

[131] *Id.*

[132] H.R. 3600, 103d Cong. (1993).

[133] CONG. BUDGET OFFICE, AN ANALYSIS OF THE ADMINISTRATION'S HEALTH PROPOSAL 1 (Feb. 1994).

[134] *Id.* at 8-9.

[135] Robert Pear, *Health Aides See a Tax on Benefits Beyond Basic Plan*, N.Y. TIMES, Sept. 5, 1993, at 1.

[136] *Id.*

premium rates for the standard package were $4,200 per year for a family policy and $1,800 per year for a single policy.[137]

A second proposal that included tax caps was the Health Equity and Access Reform Today Act of 1993. This Act was introduced by Representative William Thomas in the House of Representatives[138] and Senator John Chafee in the U.S. Senate.[139] Under the Act, employees did not include in gross income the cost of premiums provided by an employer up to an amount equal to the average cost of low-cost plans in the region.[140] Any amount above the average cost was included in the employee's gross income and was not be deductible by the employer.[141]

In 2005, the President's Advisory Panel on Federal Tax Reform, which was formed by President George W. Bush, recommended a tax cap for employer-provided health insurance premiums.[142] Under the Advisory Panel's plan, the exclusion was up to $5,000 for single plans and $11,500 for family plans.[143] Any premiums paid for by the employer in excess of the cap were included in the employee's gross income, but employers were able to deduct the entire amount paid for premiums.[144]

There are several advantages to tax caps. The first advantage is that employees are encouraged to demand less expensive health insurance from their employers.[145] Many employees want insurance with premiums that do not exceed the limit on the exclusion because they do not want to pay taxes on the additional amount of the premiums.[146] A second advantage is that the disparity between those with insurance and those without insurance is reduced.[147] A third

137 *Id.* at 38.

138 Health Equity and Access Reform Today Act of 1993 H.R. 3704, 103d Cong. (1993).

139 Health Equity and Access Reform Today Act of 1993 S. 1770, 103d Cong. (1993).

140 TAX TREATMENT, *supra* note 7, at 34.

141 *Id.*

142 PRESIDENT'S ADVISORY PANEL ON FED. TAX REFORM, SIMPLE, FAIR, AND PRO-GROWTH: PROPOSALS TO FIX AMERICA'S TAX SYS. 81 (2005), *available at* http://govinfo.library.unt.edu/taxreformpanel/final-report/TaxPanel_5-7.pdf [hereinafter PRESIDENT'S ADVISORY PANEL ON FEDERAL TAX REFORM]; *see* ELISE GOULD, HOW CAPPING THE TAX EXCLUSION MAY DISPROPORTIONATELY BURDEN CHILDREN AND FAMILIES 2 (2009), *available at* http://www.firstfocus.net/Download/GOULD.pdf.

143 PRESIDENT'S ADVISORY PANEL ON FEDERAL TAX REFORM, *supra* note 142, at 81.

144 *Id.*

145 TAX SUBSIDIES, *supra* note 8, at 15.

146 *Id.*

147 TAX TREATMENT, *supra* note 7, at 39.

advantage is that the government receives additional revenue for taxes on amounts of the premiums above the cap.[148] In addition, the cap on the exclusion may help reduce the costs of medical spending.[149]

One disadvantage of tax caps is that the caps may have an unequal effect on individuals throughout the country. If one standard amount for the tax cap was determined, some individuals will receive more benefits than other individuals who are similarly situated in other parts of the country because of price differences in policies.[150] For example, the average annual premium for a single plan in the Northeast is $5,052, while the average annual premium for a single plan in the West is only $4,683.[151] This problem could be reduced by a bill such as the Health Equity and Access Reform Today Act of 1993, which had different standard amounts for different regions. However, this could complicate the administration of the exclusion because different rates for different areas must be determined. Second, if employers are not able to deduct part of insurance premiums provided to employees, they may not provide as much health insurance as they do today.[152] As a result, insurance coverage for employees may not be as comprehensive.

D. Repealing the Exclusion

The fourth type of proposal is to repeal the health insurance premium exclusion for employees. Under a repeal of the exclusion, premiums are included as taxable compensation for employees and all other individuals are not allowed to take deductions or receive tax credits for amounts paid for insurance premiums.[153] Several proposals have included a repeal of the health insurance premium exclusion, but all of those proposals replace the exclusion with other tax benefits.[154]

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148 TAX SUBSIDIES, *supra* note 8, at 15.

149 *Id.* at 16.

150 *Id.*

151 EMPLOYER HEALTH BENEFITS, *supra* note 1, at 24. There are several reasons why health care spending varies among the different regions. These reasons include the cost of health care, severity of illness, individual income, and care preferences. For example, individuals in some areas choose low-cost health care, whereas those in other areas choose more costly health care. CONG. BUDGET OFFICE, GEOGRAPHIC VARIATION IN HEALTH CARE SPENDING 1-2 (Feb. 2008).

152 TAX SUBSIDIES, *supra* note 8, at 16.

153 David Henderson, *Reality Check*, REASON, May 1994, at 47, *available at* Academic Search Premier, ISSN 00486906.

154 *See, e.g.*, PAULY ET AL., *supra* note 4; Frum, *supra* note 77; BLUMBERG & HOLAHAN, *supra* note 88, at 1; Patients' Choice Act, S. 1099, 111th Cong. (2009); Patients' Choice

Under the national health insurance proposal by Pauly, Danzon, Feldstein, and Hoff, the health insurance premium exclusion is eliminated, but it is replaced with tax credits.[155] The Heritage Plan by Stuart Butler eliminates the health insurance premium exclusion and creates tax credits that are phased out at different income levels.[156] Senator McCain,[157] and Senators Coburn and Burr, as well as Representatives Ryan and Nunes[158] proposed to replace the exclusion for employer-provided health insurance with tax credits. President Bush,[159] along with Senators Ron Wyden and Robert Bennett,[160] proposed to repeal the exclusion and replace it with a tax deduction. However, there is a possibility that the exclusion for employer-provided health insurance could be repealed without any tax benefits.

There are several advantages to repealing the health insurance premium exclusion. One advantage is that repealing the exclusion would reduce the unequal treatment between individuals who receive employer-provided health insurance and those who do not.[161] The second advantage is that it would raise income tax revenues.[162] All employees would be required to include the cost of the premiums paid by their employers in gross income, which would increase taxes paid to the government. If these benefits were taxed, the federal government would have raised $131 billion in additional revenues in 2008.[163] The third advantage is that health care spending could be reduced.[164] For example, the exclusion reduces the net cost of insurance, which would encourage workers to obtain more coverage even though the cost of

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Act, H.R. 2520, 111th Cong. (2009); LYKE & WHITTAKER, *supra* note 15; Healthy Americans Act, S. 391, 111th Cong. (2009).

155 *See* PAULY ET AL., *supra* note 4*; see also supra* text accompanying notes 72-76.

156 *See* Frum, *supra* note 77*; see also supra* text accompanying notes 77-81.

157 *See* BLUMBERG & HOLAHAN, *supra* note 88, at 1*; see supra* text accompanying notes 88-89.

158 *See* Patients' Choice Act, S. 1099, 111th Cong. (2009); Patients' Choice Act, H.R. 2520, 111th Cong. (2009); see *also supra* text accompanying notes 90-95.

159 *See* LYKE & WHITTAKER, *supra* note 15*; see also supra* text accompanying notes 107-109.

160 *See* Healthy Americans Act, S. 391, 111th Cong. (2009)*; see also supra* text accompanying notes 110-115.

161 TAX TREATMENT, *supra* note 7, at 52.

162 *Id.* at 47.

163 OFFICE OF MGMT. & BUDGET, *supra* note 2, at 301.

164 BOB LYKE, CONG. RESEARCH SERV., THE TAX EXCLUSION FOR EMPLOYER-PROVIDED HEALTH INSURANCE: POLICY ISSUES REGARDING THE REPEAL DEBATE 14, Rep. No. RL34767 (2008).

insurance increases.[165] Also, many individuals who have employer-provided health insurance have low-deductible plans in which they do not have to pay much for health care.[166] These individuals are then able to consume more health care for unnecessary reasons without paying for it. If individuals had to pay for their own health insurance, they would be more likely to purchase insurance plans with higher deductibles because those plans tend to cost less than those with lower deductibles.[167] As a result, individuals would consume less health care, which would reduce spending.[168]

There are several disadvantages to repealing the health insurance premium exclusion. First, individuals would pay higher income taxes. Taxable income of employees who receive employer-provided health insurance would increase by the amount of premiums paid by the employer. The second disadvantage is that more individuals may become uninsured. Healthy individuals may find it less beneficial to pay taxes on the cost of insurance provided by employers and may choose to become uninsured. In addition, some individuals may not be able to afford insurance because they have low incomes or they have a family with a poor health status.[169] A third disadvantage of repealing the exclusion is that there would be administrative problems. It could be difficult to measure the amount of compensation to employees who receive insurance from self-insured employers.[170] This could increase the costs to the government and employers by requiring both to maintain records and to determine the amount of compensation received by each individual employee.

V. PROPOSED SOLUTION

One aspect of the health insurance premium exclusion that no proposal takes into consideration is the significant difference between the cost of single and family plans. For example, the mean annual cost of premiums for single individuals was $4,704 in 2008, while the mean annual cost of premiums for a family of four was $12,680.[171] This

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165 *Id.*
166 Henderson, *supra* note 153, at 49.
167 *Id.*
168 *Id.*
169 TAX TREATMENT, *supra* note 7, at 48.
170 *Id.* at 52.
171 EMPLOYER HEALTH BENEFITS, *supra* note 1, at 20.

$7,976 difference is not included in the gross income of the employee who receives the family plan from an employer and would not be taxed to the employee. This difference affects the equity of the exclusion.

As noted in Part I, horizontal equity means that similarly situated individuals pay the same tax.[172] The difference between the cost of the single and family plans within the current system does not meet the requirement of horizontal equity. As an example, assume that two employees each earn an annual salary of $50,000 at the same company. The first employee is covered under a single insurance plan, while the second is covered under a family plan. Using the average annual premium amounts, the first employee would receive a total of $54,704 in compensation, and the second employee would receive $62,680 in compensation. However, both would pay taxes on only the $50,000 salary. The second employee would receive $7,976 more in untaxed compensation than the first employee. As a result, there is no horizontal equity between the two employees. Although an employer should be allowed to provide any amount of compensation to its employees, the tax law should be equitable in taxing the employees.

A proposed solution to the equity issue would be a combination of several proposals, taking into consideration the difference between single and family plans. In the authors' view, the first part of the solution would be to impose a tax cap for employees on the amount of premiums that are not included in gross income. This cap would be equal to the actual amount of the premiums paid for single health insurance plans. The amount of the single plan that is excluded from gross income should not be a national average amount, as proposed by President Clinton,[173] or a regional amount, as proposed by Representative Thomas and Senator Chafee.[174] Using a national average amount would lead to inequity because of nationwide differences in the costs of health care plans. Some individuals would be able to exclude more than is necessary, while others would not be able to exclude enough to cover the cost of a single plan in their area. In addition, this would give some discretion to employers on what kinds of benefits are to be given to employees, such as coverage for dental and eyeglasses.

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[172] *See supra* text accompanying note 5.

[173] *See* Health Security Act, H.R. 3600, 103d Cong. (1993); *see also supra* text accompanying notes 132-137.

[174] *See* Health Equity and Access Reform Today Act of 1993, H.R. 3704, 103d Cong. (1993); Health Equity and Access Reform Today Act of 1993, S. 1770, 103d Cong. (1993); *see also supra* text accompanying notes 138-141.

Married couples filing jointly who are both employed would be able to exclude the cost of employer-provided health insurance up to the cost of two single plans, one single plan for each individual, even if the insurance is provided by only one employer. Any amount of premiums paid for by employers in excess of the cost of single plans, or two single plans in the case of married couples who are both employed, would be considered taxable compensation to the employees. However, if only one spouse is employed and a couple files jointly, as only one spouse is receiving compensation, the excess amount over the cost of a single plan would be included in income.

For the second part of the proposed solution, all individuals who pay for their own health insurance would be able to deduct from gross income the amount of premiums paid for single health insurance plans.[175] If a married couple files jointly, the couple would be able to deduct the cost of premiums paid up to an amount equal to the cost of two single plans. Some employers pay only a portion of the insurance premiums for employees, and the employees pay the remaining amount. If an employee pays for a portion of an insurance plan provided through an employer, the employee should be able to deduct the amount paid, up to the amount of a single plan. For example, assume the total cost of health insurance premiums for a single employee is $4,704, the mean annual cost of premiums for single individuals. If the employee paid the entire premium, the $4,704 cost would be deducted from the employee's gross income. If the employer pays eighty percent of the

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[175] A form of health insurance that has not been discussed is Medicare because the focus of this Article is employer-provided and private health insurance. Under the Medicare system, certain individuals who are age 65 or older, who have received Social Security disability benefits for at least two years, or are suffering from end-stage renal disease do not have to pay premiums for Medicare Part A coverage, which is hospitalization insurance. David Pratt, *The New Medicare Part D Prescription Drug Benefit*, 17 ALB. L.J. SCI. & TECH. 337, 343-44 (2007). Individuals who do not qualify to receive Medicare premium-free may purchase Medicare by paying premiums. *Id.* at 344. In addition, individuals may choose to purchase Medicare Part B, which is additional medical insurance, or Medicare Part D, which is prescription insurance. *Id.* at 344, 360. Premiums paid by individuals for Medicare are treated as itemized deductions. I.R.C. § 213(d)(1)(D). Like other medical expenses, paid Medicare premiums can only be deducted if individuals itemize their deductions and if total medical expenses exceed the 7.5 percent of AGI threshold. I.R.C. § 213(a). Individuals who participate in Medicare should be treated like all other individuals who pay for their own health insurance. Therefore, under the proposed solution, Medicare premiums paid would be deducted for gross income. In addition, since most individuals who receive Medicare Part A premium-free had initially paid into the Medicare system while employed, no individual would have to include the value of the premiums for Part A in gross income under the proposed solution.

premiums, $3,763, and the employee pays twenty percent, $941, the employee would not have to include the $3,763 paid for by the employer in gross income. The single employee should then be able to deduct from gross income the $941 paid out-of-pocket so that the employee is treated similarly to those who pay for their entire single premium. If an employer provides a family plan for an employee but only pays a portion of the premium, the amount excluded or deducted from gross income depends on the value of a single plan. For example, if an employer pays the value of a single plan, $4,704, and the employee must pay the difference for a family plan of $7,976—$12,680 less $4,704—then the value of the single plan paid for by the employer would be excluded from the employee's gross income. The difference paid by the employee would not be deducted from gross income because the value of the single plan was already excluded from gross income. However, if both spouses that file jointly are employed, and one spouse obtains a family plan from an employer in which the employer pays for the value of a single plan and the employee pays the difference for a family plan, the married couple should be treated similarly to a married couple who pays for a family plan. For example, the portion of the insurance paid for by the employer, $4,704, would be excluded from the married couple's income for the first spouse. The couple could then deduct an additional amount up to the value of the single plan, $4,704, for the second spouse. The remaining $3,272—$12,680 less $4,704 less $4,704—would not be deductible.

Arguably, employees may not be willing to accept a family plan when they have to pay taxes on the additional cost of the premiums. However, it may still be beneficial for employees to accept a family plan provided by their employer. For instance, assume that a married couple has the option to either accept a family plan from one spouse's employer or to accept a single plan from the employer for the employed spouse and to pay for a single plan for the other spouse. Using the average annual premium amounts, the out-of-pocket costs to the couple can be determined, and the calculations are shown in Table 1. As shown in the table, the deduction that can be taken by the couple for the single plan purchased does not reduce the overall cost of the plan to an amount less than the taxes paid for the family plan. In addition, the tax liability of a family plan is greatly reduced if both spouses are employed. This still gives a family the benefit of lower cost for insurance, yet it allows for equity in tax treatment to single individuals.

Table 1: Comparison of Costs of Alternatives for Individuals

Alternative Plan Chosen	Cost of Plan[176]	Calculation[177]	Cost to Taxpayer
Purchase 2nd Single Plan	$4,704	$4,704 – ($4,704 x 25%)	$3,528
Family Plan: One Spouse Employed	$12,680	($12,680 – $4,704) x 25%	$1,994
Family Plan: Both Spouses Employed	$12,680	($12,680 – $4,704 – $4,704) x 25%	$818

The next part of the proposed solution would be to allow self-employed individuals to deduct the amount of a single health insurance plan from gross income. Currently, self-employed individuals may deduct the entire amount of insurance premiums paid for themselves and their families from gross income. Allowing a deduction for only the cost of a single insurance plan would provide a tax treatment that would be similar to individuals who pay their own health insurance premiums. If a self-employed individual files jointly with a spouse, the couple would be able to deduct up to the value of two single plans, which provides a similar treatment to other couples who purchase their own insurance.

The final part of the proposed solution would be for employers to deduct the full amount of health insurance premiums paid for their employees. The premiums are considered compensation to the employees, so this aspect of the current tax system should not change. Since employees would be taxed on the amount of insurance provided

[176] The figures for the cost of each plan are taken from EMPLOYER HEALTH BENEFITS, *supra* note 1, at 20.

[177] The twenty-five percent used in the calculations is the marginal tax rate for taxpayers filing under the tax status of married filing jointly who have taxable income for the 2008 tax year that is more than $65,100 but not more than $131,450. *See* INTERNAL REVENUE SERV., 2008 1040 INSTRUCTIONS 92 (2009), *available at* http://www.irs.gov/pub/irs-pdf/i1040.pdf.

by the employer that is in excess of a single plan, preventing an employer from deducting the full amount would cause the amount of the excess to be taxed twice. Also, allowing employers to deduct the full amount would encourage employers to continue providing health insurance for their employees.

VI. CONCLUSION

Any changes in the tax treatment of health insurance premiums will depend on whether equity in tax treatment or social policy is the goal. If social policy is the goal, and the government wishes to promote health insurance coverage, employer-provided health insurance should not be included in income, as is the current treatment under I.R.C. § 106(a), and self-employed individuals should continue to be able to deduct 100 percent of the cost of health insurance premiums under I.R.C. § 162(l)(1)(B). In addition, individuals who pay for their own insurance should be able to deduct from gross income the amount paid for insurance premiums, even if they do not itemize deductions. This would treat those individuals similarly to employees who receive employer-provided health insurance and self-employed individuals who purchase their own insurance.

To be truly fair to individuals, the solution must focus on equity. Any of the proposals for tax credits, deduction from adjusted gross income, or tax caps is a step in the right direction but are not truly fair to everyone. A solution that focuses on equity would limit the amount of insurance premiums that are not taxable to the amount of a single plan. This can be accomplished by having a tax cap on employer-provided health insurance in the amount of a single insurance plan, or two single insurance plans for a married couple filing jointly in which both spouses are employed. Individuals who are not covered by an employer-provided plan and self-employed individuals should be allowed a deduction from gross income in an amount up to the value of a single insurance plan or two single plans for couples filing jointly. Employers should still be allowed to deduct the full amount paid for insurance premiums as a business expense because it is compensation to employees. As a result, this solution would appear to make the tax system more equitable. Given the current climate of increased attention on health care reform, it will be interesting to see how legislators weigh and value the impact of both equity and social policy on any potential changes to the tax treatment of health insurance premiums.