## Example 1: An Uninsured Family Of Four

*Note: All figures are for 2011, the first year the policy is in effect.*

Family #1

- A family of four earns $60,000 in total compensation, but all of it comes in the form of wages, i.e. they do not get health insurance through their employer.
- On the non-group market, they would pay $8,000 for an average policy, and, $6,000 for a basic low-cost policy.
- Under current law, the family receives no tax benefit for purchasing health insurance and is treated unfairly relative to those workers who receive health care through their employer.

Patients' Choice Act

- If this family buys health insurance, they claim a credit of $5,710, which reduces their taxes (income and payroll) by $5,335.
- If this family bought an average policy ($8,000), the cost of the insurance would, in effect, drop to $2,665 ($8,000-$5,335=$2,665).
- If this same family bought the basic low-cost policy ($6,000), the family would pay only $665 ($6,000-$5,335= $665).

| | Current law | Patients' Choice Act | |
|---|---|---|---|
| | | **Average Policy** | **Switch to Basic Policy** |
| Income | $60,000 | $60,000 | $60,000 |
| | | | |
| Tax liability (income plus payroll taxes) | $10,925 | $5,590 | $5,590 |
| | | | |
| Tax savings if they buy health insurance | NA | $5,335 | $5,335 |
| | | | |
| Cost of health insurance | $8,000 | $8,000 | $6,000 |
| Net after-tax cost of buying insurance policy | $8,000 | $2,665 | $665 |
| | | | |
| Effect of Patients' Choice Act on the after-tax price of insurance | | -67% | -89% |

# Example 2: A Family of Four That Currently Gets Health Insurance Through Work

*Note: All figures are for 2011, the first year the policy is in effect.*

Family #2

- Now consider a family of four with the same $60,000 in total compensation, but $15,000 of it comes in the form of an employer-sponsored health insurance policy, of which the employer pays $11,000 and the employee contributes $4,000 on a pre-tax basis.
- This family has the same total compensation as in the above example, but their wages (and taxable income) would be $45,000.
- Under current law, if this family switched to a less expensive basic insurance policy with a $7,000 premium, they would receive $8,000 more in wages, but they would have to pay 30.3% taxes on it (15% income + 15.3% payroll). So they would, in effect, get only $5,576 higher wages for giving up $8,000 of insurance. This is why the family probably does not switch to a less expensive insurance plan under current law – it's simply not worth it.

Patients' Choice Act

- If the family changed nothing, their wages would still be $45,000, but their taxable income would rise to $60,000, because their employer-sponsored health insurance premium of $15,000 would be included in their taxable income (only for income tax purposes). However, the family would receive the new health tax credit of $5,710 and pay $3,460 *less* in taxes under the Patients' Choice Act.
- If instead the family switched to a less expensive policy with, lets say, a $7,000 premium, they would receive $1,224 less in tax savings because they have to pay payroll taxes on the additional $8,000 in wages (15.3% * $8,000). But, rather than getting only $5,576 in higher wages for giving up $8,000 of insurance under current law, this family would now get $6,776 in higher wages for giving up $8,000 of insurance. This additional savings means the family will be more likely to choose less expensive health insurance in exchange for higher wages under the Patients' Choice Act.

| | **Current Law** | **Patients' Choice Act** | **Patients' Choice Act, but the family trades low cost health insurance for higher wages** |
|---|---|---|---|
| Wages | $45,000 | $45,000 | $53,000 |
| Employer's contribution to health insurance premium | $11,000 | $11,000 | $7,000 |
| Worker's premium contribution | $4,000[1] | $4,000 | $0 |
| Compensation including wages and health insurance | $60,000 | $60,000 | $60,000 |
| | | | |
| Taxable income[2] | $45,000 | $60,000 | $60,000 |
| Tax liability (income plus payroll taxes) | $6,755 | $3,295 | $4,519 |
| | | | |
| Wage increase | | | $8,000 |
| | | | |
| Tax savings | 0 | $3,460 | $2,236 |
| Type of health insurance | Average | Average | Basic |

[1]Under current law, worker's share of premium is assumed to be made on a pre-tax basis through a cafeteria plan.
[2]Taxable earnings subject to Social Security and Medicare taxes would change from $45,000 under current law (and the Patients' Choice Act) for the average insurance policy to $53,000 for the basic insurance policy.

## Example 3: An Uninsured Single Mom With 2 Children

*Note: All figures are for 2011, the first year the policy is in effect.*

Family #3

- A single mom with two children has $20,000 of total compensation, all of it coming in the form of wages. If she were to purchase health insurance on the non-group market, she would pay $8,000 for an average policy, and $6,000 for a basic low-cost policy.

Patients' Choice Act

- Under the Patients' Choice Act, if this mom were to buy health insurance, she would claim a credit of $5,710. In addition, she would claim a supplemental subsidy of $4,000. In total, her total savings would be $9,710.
- If she bought the average $8,000 policy, she would get back $1,710 to be deposited into an HSA or similar account to cover future health care expenses. If she bought a lower-cost policy, at, let's say $6,000, she would get back $3,710 to be deposited into an HSA or similar account to cover future health care expenses.
- Whether she purchases the average policy or switches to a lower cost policy, the Patients' Choice Act would fully cover the cost of her insurance and leave money left over to cover other health care expenses.

| | **Current law** | **Patients' Choice Act** | |
|---|---|---|---|
| | | **Average Policy** | **Switch to Basic Policy** |
| Income | $20,000 | $20,000 | $20,000 |
| | | | |
| Tax liability (income plus payroll taxes) | $2,547 | $8,257 | $8,257 |
| | | | |
| Tax savings if they buy health insurance | NA | $5,710 | $5,710 |
| | | | |
| Supplemental subsidy for lower income households | | $4,000 | $4,000 |
| | | | |
| Total savings under Patients' Choice Act | | $9,710 | $9,710 |
| | | | |
| Cost of health insurance (average policy) | $8,000 | $8,000 | $8,000 |
| Net after-tax cost of buying the basic policy | $8,000 | 0 | 0 |
| | | | |
| Amount for deposit into HSA-type account for future health expenses | 0 | $1,710 | $3,710 |

## Example 4: A Family of Four That Now Gets Health Insurance Through Work

*Note: All figures are for 2011, the first year the policy is in effect.*

Family #4

- A family of four earns $100,000 of total compensation with an average cost employer-based insurance policy that costs $15,000 in 2009, of which the employer contributes $11,000 and the employee pays $4,000 on a pre-tax basis). This family's current wages (and taxable income) are $85,000.
- Under current law, if this family switched to a less expensive basic insurance policy with a $6,000 premium, they would get $8,000 in higher taxable wages, but they would have to pay about 30.3% taxes on it (15% income + 15.3% payroll). So they would, in effect, get only $5,576 higher wages after taxes for giving up $8,000 of insurance. This is why the family probably does not switch to a less expensive plan under current law – it's not worth it.

Patients' Choice Act

- If the family changed nothing, their wages would still be $85,000, but their taxable income would rise to $100,000, because their employer-sponsored health insurance premium of $15,000 would be included in their taxable income (only for income tax purposes). However, the family would receive the new health tax credit of $5,710 and pay $3,460 *less* in taxes under the Patients' Choice Act.
- If instead the family switched to a less expensive policy with, lets say, a $7,000 premium, they would receive $1,224 less in tax savings because they have to pay payroll taxes on the additional $8,000 in wages (15.3% * $8,000). But, rather than getting only $5,576 in higher wages for giving up $8,000 of insurance under current law, this family would now get $6,776 in higher wages for giving up $8,000 of insurance. This additional savings means the family will be more likely to choose less expensive health insurance in exchange for higher wages under the Patients' Choice Act.

| | **Current Law** | **Patients' Choice Act** | **Patients' Choice Act, but the family trades low cost health insurance for higher wages** |
|---|---|---|---|
| Wages | $85,000 | $85,000 | $93,000 |
| Employer's contribution to health insurance premium | $11,000 | $11,000 | $7,000 |
| Worker's premium contribution | $4,000[1] | $4,000 | $0 |
| Compensation including wages and health insurance | $100,000 | $100,000 | $100,000 |
| | | | |
| Taxable income[2] | $85,000 | $100,000 | $100,000 |
| Tax liability (income plus payroll taxes) | $17,945 | $14,485 | $15,709 |
| | | | |
| Wage increase | | | $8,000 |
| | | | |
| Tax savings | 0 | $3,460 | $2,236 |
| Type of health insurance | Average | Average | Basic |

[1]Under current law, worker's share of premium is assumed to be made on a pre-tax basis through a cafeteria plan.
[2]Taxable earnings subject to Social Security and Medicare taxes would change from $85,000 under current law (and the Patients' Choice Act) for the average insurance policy to $93,000 for the basic insurance policy.

**SOURCE:** Robert Carroll, "Reengineering the Tax Treatment of Health Care: The Patients' Choice Act," Tax Foundation Fiscal Fact, June 2009.

**Biography for Dr. Carroll**

Dr. Robert Carroll is Senior Research Fellow at the Tax Foundation. His special focus is on business taxation and the need for corporate tax reform. Dr. Carroll most recently served as the Deputy Assistant Secretary for Tax Analysis in the Office of Tax Policy at the Department of the Treasury, a position he began in December of 2003. Previously, he was a Visiting Scholar in the Tax Analysis Division of the Congressional Budget Office. From July 2002 to June 2003 he served as a Senior Economist (Public Finance) with the President's Council of Economic Advisers. He holds a Ph.D. and a master's degree in economics from Syracuse University and a B.S. in economics from State University of New York.

NOTE: Modeling assumes the average cost of employer-sponsored insurance in 2011 is $15,000.

2) Based on 2006 data from the Medical Expenditure Panel Survey (MEPS), insurance in the non-group market will cost roughly $8,000 in 2011 (i.e., $6,160 in 2006 grown at 6% rate for five years).