

findings brief

By Megan Ix

Early Experiences with Federal Health Insurance Tax Credits

key findings

The Health Coverage Tax Credit has returned mixed results, primarily because of the complexity of the program.

In 2002, the U.S. Congress enacted a new health insurance tax credit, the Health Coverage Tax Credit (HCTC) to subsidize the purchase of coverage for certain individuals, particularly early retirees and workers displaced by international trade, who might otherwise be uninsured. The HCTC was passed as part of the federal Trade Adjustment Assistance Reform Act of 2002 (TAA Reform Act). The HCTC subsidized health care by making a 65 percent partial premium subsidy available to those eligible and their dependents.

Since then, there have been a variety of tax-based strategy proposals to expand health care coverage for the American population. In January of 2007, President Bush proposed to reform the tax code to create a standard tax deduction for all Americans with health insurance, giving people who buy their own health insurance equal tax breaks with those covered through their

jobs.¹ This plan was met with mixed reactions; some agreed tax exclusion for employer-sponsored health insurance damages the system, others argued that insurance would still be unaffordable to many, and would cause insurance markets to become unstable.² In the end, the President's proposal was unsuccessful.

Since then, new proposals have emerged using different forms of tax credits to increase health coverage. The goal of most is to amend the tax code, which currently only benefits employer-based health care, in order to increase coverage and make it more affordable. The proposals recommend policies such as detaching health insurance from employment, guaranteeing insurance to all Americans, and providing taxes and subsidies to both individuals and families. Tax credits ranging anywhere from \$2,160 for individuals to up to \$15,000 for families have been proposed, as well as a proposal



Robert Wood Johnson Foundation

Changes in Healthcare Financing and Organization is a national program of the Robert Wood Johnson Foundation administered by AcademyHealth.



AcademyHealth

which opts for sliding scale income tax credits in addition to the expansion of other federal health care programs.^{3,4,5} These proposals have also been met with mixed reviews; while some support the proposals, others would argue that tax credits alone will not solve the problems of the U.S. health care system, and might even create more problems by working to eliminate employer-based plans.

An examination of the HCTC could provide valuable lessons to inform the current debate over tax credits. Although this program is relatively small, with only an estimated population of 500,000 eligible persons and their dependents per year, it can provide important insights to future policy. In 2004, HCFO funded Karen Pollitz, M.P.P., at Georgetown University to examine the early experiences with the Federal Health Insurance Tax Credits. In particular, Pollitz examined the following questions:

1. What qualified coverage options do states establish and why?
2. How do state decisions impact the ability of people to claim the HCTC?
3. Who is helped by the HCTC?

Findings show that the first experiments with health insurance tax credits returned mixed results.⁶ Enrollment in the program has been estimated to reach only between 7 and 21 percent of persons identified as eligible.⁷ In addition, the author found that the HCTC built upon, replicated, and even aggravated other features in the health care system that create barriers to access and increased the cost of coverage, especially for people with health problems.

Methodology

The researcher used a qualitative approach to investigate aspects of the HCTC program. Interviews with key state-based officials were conducted to compile information about qualified coverage options in each state and explore factors affecting state decision-making. Information that

states collected and released around the HCTC program was reviewed by project staff, and the project also documented other important features on state-based coverage options.

HCTC Overview

The HCTC subsidizes the cost of premiums for qualified health care coverage. Some qualified coverage options are available to all HCTC-eligible persons, while other options are only available in specific states. All persons can apply the credit to COBRA coverage where available, or apply it to any coverage offered through their spouse's employer health plan, provided that employer pays less than 50 percent of the premium. Under limited circumstances, tax credit can be applied to an individually purchased health insurance policy, but the person must have been covered under the policy for at least 30 days before losing their job. Eligible individuals may also obtain state-specific coverage options, of which there are seven forms of state qualified coverage that states can choose from.

The HCTC program has three main categories of eligible individuals: those eligible for benefits under the Trade Adjustment Agreement (TAA), those eligible for Alternative Trade Adjustment Assistance (ATAA), and those who receive benefits under the Pension Benefit Guaranty Corporation (PBGC).

TAA is designed to help and train certain displaced workers who lose their jobs because of foreign imports; those eligible for ATAA must be eligible for TAA, be age 50 or older, and have become employed at a lower wage job. PBGC candidates for HCTC are at least 55 years old and not enrolled in any other specified coverage, such as Medicare. In addition to these groups, the spouse and dependents of HCTC recipients may also be eligible for the credit.

Other key characteristics of the HCTC include that it is refundable, payable in advance, and is an open-ended spending program. The administration of the HCTC

includes multiple organizations, with the lead agency being the Internal Revenue Service (IRS). Other agencies include the U.S. Treasury, the U.S. Department of Labor (DOL), state workforce agencies, and insurance agencies.

Key Findings

To date, the HCTC program has proven to be a highly complex and expensive program for the federal government to administer, for health insurers and health plans to participate in, and for consumers to understand and use.

Outreach and Eligibility

The many layers of complexity in the system deter use by customers, as illustrated by the low uptake rate of the program among eligible persons. Pollitz found that although the IRS did engage in extensive public education and outreach as the HCTC began, the outreach was scaled back in the second year due to budgetary constraints. In addition, since HCTC eligibility is dependent upon eligibility under TAA, ATAA, or PBGC, it can be very challenging to navigate all of the enrollment factors.

Individual Cost and Advance Payment Subsidy

Although the HCTC significantly subsidized coverage, cost is still an inhibitor to enrollment in the HCTC. The 35 percent share of premiums still constituted a substantial expense for many individuals.⁸ While the program offers an advance payment subsidy, Pollitz notes that initiating this subsidy requires a lengthy process, and five months or more could elapse from time of layoff to when the advance payment subsidy begins. Individuals who cannot afford to pay premiums during this transition period typically experience a gap in coverage, which if longer than 63 days can subject individuals to medical underwriting or a pre-existing condition exclusion period.

Qualified Coverage

The layers of complexity in joining the HCTC program include identifying qualified coverage plans. The IRS attempts to

provide an up-to-date list of state coverage options for potential enrollees, but because the programs are so small, staff at the insurance companies are often not familiar enough with the program specifics to assist eligible persons.

Costs of the Program

The Government Accountability Office found that the IRS invested \$69 million in start-up costs to establish the administrative mechanism to deliver the advance payment subsidy and to develop program materials. In the first year, each dollar of subsidy was costing a dollar in administrative costs. Pollitz found that overwhelmingly, the administrative costs for the HCTC program were attributable to the costs of operating the advance payment premium subsidy. Added administrative costs in payment processing may also inhibit health care insurers from participating in the program.

Pollitz also examined the possibility of economies of scale with the HCTC program. She found that the most expensive administrative cost components were those that involved one-on-one assistance, either with beneficiaries or health plans.⁹ Because of this, and the complexity of the program rules, eligibility, and payment procedures, economies of scale seem unlikely.

Overall, Pollitz found that while the federal government was able to identify a target population, set some standards for qualified coverage and establish a mechanism for delivering premium subsidies in real time, this particular program proved inadequate for most HCTC-eligible individuals to participate.

Policy Implications

The results from this study on the HCTC program indicate there are lessons to be learned for future policy decisions around the use of tax credits to increase health care coverage. In particular, the findings point to the need for policymakers to strongly consider the details of tax credit programs, particularly implementation. In some cases, simplicity may be more important than having many choices, particularly when the choices are challenging to navigate.

Evidence from this study shows that future tax credit plans may need to reduce the complexities in eligibility, enrollment, and payment systems to be successful and increase coverage. In addition, higher or full subsidies may have to be considered to increase likelihood of enrollment. Positive experiences from some individual states indicate the potential for health tax credits to offer affordable individual coverage, but there are many factors to be considered when evaluating if future health care tax credits will be both efficient and effective.

The 2002 TAA Reform Act is set to expire on September 30, 2007. A bill has been introduced to reauthorize the program, and it includes some programmatic improvements, such as increasing the health insurance subsidy to 85 percent of premiums, eliminating some of rules that limit eligibility, revising the application process, and doubling federal spending on the program. Passage of the bill remains uncertain at this time.

Endnotes

- 1 Wines, L. "President calls for health insurance tax deduction." *MarketWatch*, Feb 17, 2007. Also see: <http://www.marketwatch.com/news/story/bush-calls-tax-reform-health-care/story.aspx?guid=%7BA033D1DC-F48A-4800-BAB6-DB7EBA5C36B9%7D>
- 2 "Reactions to the State of the Union Address." *The Wall Street Journal Online*, January 23, 2007. Also see: <http://online.wsj.com/article/SB116960576529585829.html?mod=googlewsj>
- 3 "Republican Senators Unveil Universal Health Coverage Tax Credits for Those Who Purchase Private Insurance." *Capitol Hill Watch*, Kaiser Daily Health Policy Report. July 27, 2007. Also see: http://www.kaisernetwork.org/daily_reports/health2008dr.cfm?DR_ID=46528
- 4 "Republican Presidential Candidate Giuliani To Announce Tax Credit Proposal to help U.S. Residents Purchase Individual Health Insurance." *Election 2008*, Kaiser Daily Health Policy Report. July 31, 2007. Also see: www.kaisernetwork.org/daily_reports/rep_index.cfm?hint=3&DR_ID=46585
- 5 "Democratic Presidential Candidate Richardson Unveils Universal Health Care Plan that Would Expand Preventive Coverage." *Kaiser Daily Health Policy Report*. August 8, 2007.
- 6 Pollitz, K. "Complexity and Cost of Health Insurance Tax Credits." *Journal of Insurance Regulation*, 25(4), 2007, pp.3-22.
- 7 Committee of Ways and Means, "Testimony of Karen Pollitz; Health Coverage Tax Credit (HCTC)." June 14, 2007.
- 8 *ibid.*
- 9 Pollitz, K. "Complexity and Cost of Health Insurance Tax Credits." *Journal of Insurance Regulation*, 25(4), 2007, pp.3-22.