Tax Credits and Purchasing Pools: Implications for Affordable Health Insurance.

Prepared for the SJR 22 Subcommittee on Health Care and Health Insurance
by Gordy Higgins, Legislative Services Division

Introduction

State and Federal policymakers have struggled for years with ways to control rising health care costs, decrease the number of uninsured people, and provide access to affordable, quality health care services. Over the last 15 years in Montana, at least four study projects were completed by Legislative interim committees, Executive Branch agencies, and special task forces. That doesn't include the research efforts conducted by interest groups, industry associations, and consumer advocates, or the dozens of bills were introduced, debated, and acted upon in Montana and in the nation's capitol. The proposals took the shape of sweeping reform packages, incremental changes, and everything in between. The result is a complex collection of federal and state law that makes the process of finding solutions exceedingly difficult. This interim, the SJR 22 Subcommittee on Health Care and Health Insurance has been asked to conduct a comprehensive study of health care costs and health insurance coverage in Montana and recommend policy ideas to the next Legislature. One of the Subcommittee's two goals is to develop strategies to increase the number of people who have access to affordable health insurance coverage.[1] One way to achieve that goal is to uncover whether changes to tax policy, either alone or in conjunction with other policy ideas, would lower the percentage of the uninsured.[2]

There are a few provisions in Montana tax law that offer credits and deductions as a way for individuals and businesses to meet their needs to provide health insurance and contain costs associated with health insurance and health care.[3] Past Montana Legislative sessions have entertained numerous proposals to offer tax credits for the purpose of assisting businesses and individuals purchase health insurance.

The question for the SJR 22 Subcommittee is to determine whether tax credits are an effective way to meet the goal of increasing insurance coverage in the state. Within that basic question lie several specific questions. Those questions include determining the fiscal impact of a proposed tax credit, how a tax credit proposal ought to be structured in order to target a specific component of the uninsured population, how the tax credit should be structured to ensure ease of use by taxpayers and administration by the Department of Revenue, and, if viewed as one piece of the state's health policy puzzle, whether a tax credit should be combined with other ideas to

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[1]The second goal is to develop policies to provide quality health care services in a cost-effective way.

[2]The reader should not infer from this statement that the Subcommittee is only looking at tax policy as a way to increase insurance coverage. Other specific ideas have been raised, including the possibility of expanding existing public insurance programs. That latter idea, along with numerous others, will be part of the comprehensive study approach.

[3]Tax law in Montana is contained in Title 15, MCA.

maximize effectiveness.

This paper provides a series of questions and suggestions raised by health and tax policy analysts, a brief description of existing Montana tax policies related to health insurance and health care, and a possible direction for future Subcommittee action.

Tax-Based Programs and Purchasing Pools to Increase Health Insurance Coverage

Whether it be the deductibility of health insurance premiums or refundable tax credits the tax system at the state and federal level is an important source of subsidy for health insurance coverage. Tax deductibility is likely to help those in higher income brackets who pay higher taxes, whereas refundable credits would extend some benefit to those that may not have any tax liability and have either opted not to take up employer-sponsored coverage or have no access to employer-sponsored coverage.

Focusing, for the time being, only on refundable tax credits begins to illustrate a few key points that health policy experts suggest lawmakers consider. First, if refundable tax credits are established for individual taxpayers, some analysts advise that they be designed to complement existing coverage sources, such as allowing eligible employees to use the credit to fund their portion of the contribution to an employer-sponsored plan.[4] Another option that has been proposed is to allow people with tax credits to buy into public programs, or combine public subsidies with tax credits to make coverage in the individual market more affordable.[5] If neither of these options prove workable, the recipients of tax credits must access the individual market to find coverage. In the individual market, insurer's usually rate the risks of the individual and base rates on a person's age, health status, and previous illnesses. Analysts from the Center for Studying Health System Change, state that without significant reforms in the individual market, namely underwriting restrictions, the success of tax credits for purchasing health insurance may be disappointing.[6]

Recently, the move has been to determine whether individual solutions that have exhibited limited success can be combined to provide a more comprehensive answer to the issue of high uninsured rates. One area that seems to be gaining momentum is merging tax credits with health insurance purchasing pools. The concept behind purchasing pools is that they may offer similar advantages currently being realized by large group plans or large employer plans. Purchasing pools have the effect of providing additional choices for consumer, pooling risks, achieving greater bargaining power in the market, and promoting potential cost-savings as a result of

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[4] *Stand-Alone Health Insurance Tax Credits Aren't Enough*, Center for Studying Health System Change, Issue Brief No. 41, July 2001.

[5] Ibid.

[6] Ibid.

economies of scale.[7] The rationale behind this marriage of ideas is that by mimicking large employers, which a purchasing pool is designed to do, individuals seeking health insurance would be brought together on the basis of income, not health status. In effect, pool participants would realize the benefits of group rating mechanisms rather than individual risk rating.

There are a number of design issues associated with developing effective purchasing pools combined with refundable tax credits. Just of few of these include determining who is eligible for the tax credit and enrollment into the pool; what would the standard benefit package be; how the pools would interact with existing state insurance regulations such as mandated benefit requirements; whether all small employers must purchase coverage through the pool; and whether to require that anyone receiving a tax credit be required to join a pool.[8]

As the SJR 22 Subcommittee begins its deliberations on the various approaches designed to expand insurance coverage and make coverage more affordable to those who have it now, it must work to understand what opportunities exist currently in Montana and how restructuring those opportunities will best meet the goals and objectives the Subcommittee has established. The remainder of this paper lays the groundwork for additional work in the area of tax policy considerations by describing, briefly, what the Subcommittee has to work with.

Montana Tax Policy Provisions

The Department of Revenue (Department), each biennium, releases a report which describes the provisions and forecasts the tax expenditures each credit or deduction equals. As part of that report, the Department estimates revenue losses associated with the use of a variety of tax deductions, credits, and exclusions. This loss of revenue, or tax expenditure, represents a good approach for the Subcommittee to recognize what tax policies exist as they relate to health insurance and health care and the estimated use, in terms of percentage of Montanans, and overall cost.

A tax expenditure is a provision of the tax code that provides for special exclusions, exemptions, deductions, deferrals, or preferential tax rates that result in forgone revenue.[9] Generally, the purpose of a tax expenditure is to provide financial assistance to a certain group of taxpayers, or provide an economic incentive that encourages specific taxpayer behavior. In most cases, financial assistance or behavioral incentives could be accomplished through direct government

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[7]Alain Enthoven, "Health Plan Purchasing Cooperatives: Helping the Market to Work for Consumers Who Are Not Sponsored by Large Employers," Discussion Draft, January 7, 2000.

[8]Health Care Financing & Organization, Findings Brief, Vol. 4, Issue 1, June 2000, and *Stand-Alone Health Insurance Tax Credits Aren't Enough*, Center for Studying Health System Change, Issue Brief No. 41, July 2001.

[9]Montana Department of Revenue, Biennial Report, July 1, 1998 to June 30, 2000, p 103.

spending programs to those targeted groups.[10] In their Biennial Report, the Department provides some guidelines for policymakers when using tax expenditures as a way to assist in developing new policy directions. In effect, tax expenditure estimates should be viewed as a measure of the amount of relief, assistance, or subsidy currently being provided through the tax codes, and not necessarily as the amount of revenue that would be realized by repealing expenditure provisions currently in law.[11] What follows is a description of various tax expenditure provisions in law that may affect decisions related to health care and health insurance.

Individual Income Tax Exemptions and Exclusions

The Montana Medical Savings Account (15-61-202, MCA)

The medical savings account offers resident taxpayers an opportunity to save money for medical expenses by contributing money to an account administered by either an account administrator or the resident taxpayer. The taxpayer may contribute any amount to the account, but only the first $3,000 annually may be used to reduce taxable income. Money left in the account, or withdrawn for eligible medical expenses, is not subject to taxation in Montana, but is subject to taxation at the federal level.

Eligible medical expenses are defined by the IRS Code Section 213 (d) and include items such as health insurance premiums, prescription drugs, medical, dental, and nursing care, eyeglasses, crutches, hearing aids, and certain travel and lodging expenses associated with receiving medical care. Long-term care insurance for the account holder or the account holders dependents is also an eligible expense that would not be subject to taxation if withdrawn.

Medical Insurance Premium Expense Deduction (15-30-121 (1), MCA)

Montana tax law allows taxpayers to deduct allowable health insurance premiums. The premiums must be paid by the taxpayer with after-tax dollars. The purpose of this deduction is to provide assistance to taxpayers paying out-of-pocket insurance premiums.

Medical and Dental Expenses (15-30-121 (1), MCA)

Expenditures for specified medical expenses are deductible to the extent that they exceed 7.5% of the taxpayer's adjusted gross income. This deduction targets both taxpayers who have unusually large and unplanned medical costs and taxpayers who may not have health insurance.

Disability Insurance Tax Credit (15-30-129, MCA and 15-31-132, MCA)

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[10] *Ibid*., p. 103.

[11] *Ibid*., p 105.

Employers with 20 or fewer employees may obtain a non-refundable tax credit up to $3,000 for expenditures on employee health insurance premiums.[12] The credit may not exceed 50% of the premium cost of each employee and may not be claimed for a period of more than three years and the employer may not be granted the credit within 10 years of the last consecutive credit claimed. This credit may be applied against individual income taxes or corporation license taxes. The Department estimates that this tax credit results in a tax expenditure of less than $25,000.

Table 1, shown below, provides an estimate by income group of the tax expenditures associated with individual income tax deductions and exclusions.

Table 1: Income Tax Expenditures by Decile Group, Specific Deductions, Forecast Tax Year 2001[13]

Decile Group	Income Bracket	Medical Savings Accounts		Medical Insurance Premium		Medical Deductions	
		#	Percent	#	Percent	#	Percent
1	$0 - 5,900	1	0.00%	56	0.02%	65	0.02%
2	$5,901 - 7,250	4	0.02%	759	0.18%	680	0.26%
3	$7,251 - 13,680	13	0.14%	3,314	1.16%	2,555	1.48%
4	$13,681 - 17,600	44	0.79%	5,083	2.57%	3,456	2.95%
5	$17,601 - 21,140	93	1.66%	7,358	5.29%	4,744	5.48%
6	$21,141 - 32,500	150	3.86%	9,982	8.72%	6,268	9.60%
7	$32,501 - 37,200	205	5.93%	10,691	11.78%	6,457	12.71%
8	$37,201 - 52,260	287	11.22%	12,684	16.46%	7,330	17.85%
9	$52,261 - 70,940	410	19.98%	14,139	21.52%	7,679	20.88%
10	$70,941 - +	734	56.41%	16,110	32.30%	5,865	28.77%

Compiled from the *Biennial Report of the Department of Revenue*, July 1, 1998 to June 30, 2000.

[12]The term "disability insurance" as defined in 33-1-207, MCA, includes health insurance within its meaning.

[13]Each Decile Group includes one-tenth of all households filing income tax returns. The first decile group includes households with the very lowest incomes, while the tenth decile group includes those households having the highest incomes. The decile groups are based on actual 1999 incomes, but the tax expenditures are those projected to calendar year 2001.

Conclusion

Using tax credits in combination with purchasing pools is an idea that may offer lawmakers an opportunity to tailor an effective solution to address health insurance coverage in Montana. By understanding how existing deductions and credits are used today, and designing a purchasing pool concept that reaches a targeted section of the uninsured and underinsured, the SJR 22 Subcommittee may be able to take a small but important step toward helping Montanans achieve access to affordable health insurance.