CALIFORNIA BUDGET PROJECT

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WOULD THE GOVERNOR'S PROPOSED TAX CREDIT MAKE HEALTH CARE AFFORDABLE?

The Governor has proposed a new tax credit aimed at helping make health premiums affordable as part of his health reform plan. The Governor's proposal would provide assistance to certain families with incomes up to 350 percent of the poverty line ($72,275 for a family of four) to purchase health coverage through a new public purchasing pool. However, the credit would not help many families with high health costs because they would not qualify for assistance. Most Californians who have incomes that would make them eligible for the credit have job-based coverage and thus would not qualify under the Governor's proposal. In addition, the tax credit would only apply to the cost of very basic health coverage – which would likely include a high deductible. Families who receive the credit and want more comprehensive coverage would not receive assistance with the additional cost. The tax credit also would provide employers with an incentive to stop providing health coverage because workers could not receive the credit if they have health coverage through their employer.

What Does the Governor Propose?

The Governor proposes to create a new subsidy linked to a state income tax credit that aims to help reduce families' health care premiums. The credit, designed as a subsidy, is targeted to families who have incomes somewhat higher than those who would be eligible for direct premium subsidies (Table 1).[1] Individuals or families could receive the subsidy if:

- They have adjusted gross incomes (AGI) between 250 percent and 350 percent of the poverty line (between $51,625 and $72,275 for a family of four);[2]
- Neither the individual nor the spouse works for an employer who offers job-based coverage; and
- They purchase coverage through a new public purchasing pool administered by the Managed Risk Medical Insurance Board (MRMIB).

The size of the subsidy would equal the amount by which the premium cost for "minimum coverage" exceeds 5 percent of a family's AGI. The current proposal does not define "minimum coverage"; however, the Governor's January health proposal defined it as coverage with a $5,000 deductible and maximum out-of-pocket costs of $7,500 for individuals and $10,000 for families. If families purchase more comprehensive coverage, they would have to pay the full additional cost of that coverage. The credit would not cover copayments, deductibles, or other out-of-pocket costs or other costs such as dental and vision care that are not included in the basic coverage.

Table 1: Income Limits for Proposed Tax Credit

Family Size	Lower Income Limit	Upper Income Limit
1	$25,525	$35,735
2	$34,225	$47,915
3	$42,925	$60,095
4	$51,625	$72,275
5	$60,325	$84,455

Source: US Department of Health and Human Services

The credit is designed to provide a monthly subsidy to families who buy coverage through the public purchasing pool. If families receive the credit in the form of a subsidy, it would reduce the amount they pay to MRMIB for coverage. The credit would not be paid directly to workers as a cash advance. Taxpayers may choose to claim the credit at filing time, but they would have to pay the full amount of their premiums to MRMIB on a monthly basis.

The advance payment provisions of the credit would add the total of any subsidies received to taxpayers' income tax liability. The credit would then be used to reduce individuals' tax liability when they file their return. For example, if a family appears to qualify for an estimated credit of $2,400 for the year, the credit would lower the family's monthly premiums by $200. If, at the end of the year, the family is eligible for a tax credit of $2,400, the subsidies would exactly offset the credit. However, if the family turns out to be eligible for a smaller credit or no credit at all, they would have to pay back part or all of the $2,400 in subsidies they received.

The Proposed Credit Would Help Few Families with Their Health Care Costs

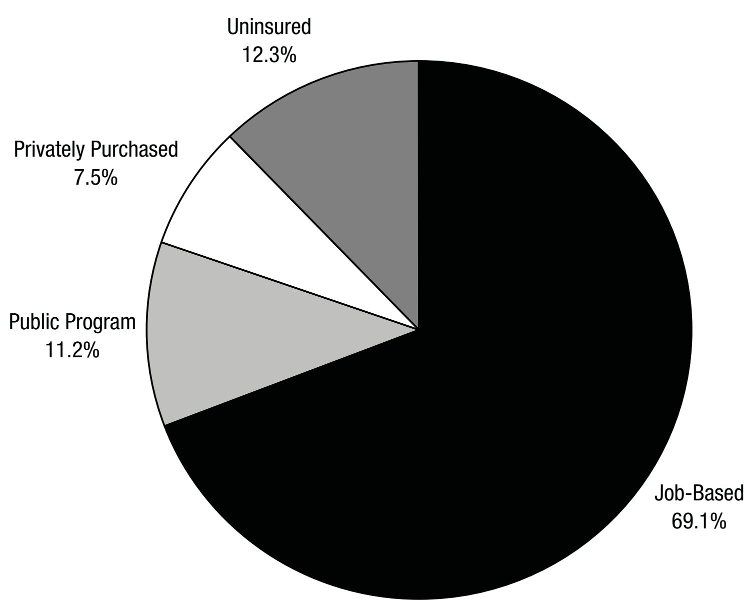
The proposed tax credit would help relatively few Californians purchase health coverage because it would only be available to families with incomes between 250 percent and 350 percent of the poverty line who do not have job-based coverage. Only one in five non-elderly Californians (19.8 percent) with incomes in this range could potentially claim the credit because they are uninsured or purchase health insurance on the private market (Figure 1). In contrast, seven in 10 non-elderly Californians with incomes in this range (69.1 percent) have job-based coverage and 11.2 percent have coverage through a public program such as Medi-Cal or Healthy Families.

Families with job-based coverage could not claim the credit, despite the fact that many pay large amounts for premiums and out-of-pocket costs. Recent research estimates that half of families with incomes between 251 percent and 300 percent of the poverty line who have job-based coverage spend more than 5.3 percent of their incomes on health costs. One-quarter of these families spend at least 6.1 percent of their incomes on premiums alone, and one in 10 spend at least 11.4 percent of their incomes on premiums.[3]

Tax Credit Would Only Apply to the Cost of Minimum Coverage

The proposed tax credit would limit the amount that families pay for premiums to 5 percent of their incomes only if they qualify for the credit and purchase the most basic coverage available

Figure 1: Most Californians with Incomes Between 250% and 350% of the Poverty Line Have Job-Based Coverage



Type of Health Coverage for Californians Under Age 65, 2005

Source: CBP analysis of UCLA Center for Health Policy Research data through the new purchasing pool. If families want to purchase more than the basic coverage, which is likely to include a sizable deductible, they would have to pay all of the additional cost themselves. In addition, families purchasing the minimum coverage would likely spend much more than 5 percent of their incomes on total health care costs due to deductibles and copayments as well as the cost of benefits not covered by the plan, such as vision and dental care. Families with substantial health care needs who qualify for the credit would also be likely to spend more than 5 percent of their incomes on health care if they enroll in coverage through the purchasing pool, either because they would face high out-of-pocket costs if they choose the most basic coverage, or because they would have to pay higher premiums to access a more comprehensive plan.

The share of their incomes that families eligible for the credit would spend on premiums depends on what type of coverage they purchase. For example, if the premium cost for the most basic health coverage through the purchasing pool is $6,000 per year for a family of four, a family with an AGI of $70,000 would be eligible for a credit of $2,500 and have a net premium cost of $3,500 (5 percent of $70,000).[4] However, if the same family wanted to buy coverage with a lower deductible, it might cost $10,000 per year. The family would receive the same tax credit of $2,500 but would have to pay the additional $4,000 cost of the better coverage, for a net premium cost of $7,500 per year, or 10.7 percent of their income on premiums alone. The family would not be eligible for the tax credit if they do not purchase coverage through MRMIB.

Proposal Could Cause Problems for Families Whose Incomes Fluctuate

The Governor's proposal could create problems for families whose incomes vary throughout the year. Since eligibility for the tax credit is based on a family's annual income, families will not know with certainty how large a credit they would qualify for before the year ends. For example, hourly workers often have schedules that vary. These workers may choose to receive the credit in the form of a monthly subsidy to reduce their health care premiums, but then could have to pay back part or all of the credit if they work more hours at the end of the year. For example, a worker may qualify to receive a $100 premium subsidy from the tax credit for 10 months based on an expected AGI of $32,000. However, if her actual AGI is $36,000 due to working overtime during the holiday season, she would not qualify for the tax credit and would have to pay back the $1,000 in subsidies she received when she pays her taxes the following year. A similar situation could occur for salaried workers who receive a raise during the year.

Families whose incomes vary would likely be hesitant to use the tax credit to reduce their monthly premiums. To the extent that families do not receive the credit as a monthly subsidy, the credit would not be successful in helping make health care affordable. Research on the federal Earned Income Tax Credit – a refundable tax credit for low-income working families – suggests that families would be hesitant to use premium subsidies to reduce their monthly health costs in part due to fear that they could have to pay back part or all of the credit.[5]

Variations in families' incomes would also create complexity for MRMIB and families. MRMIB could be forced to recalculate families' subsidy amounts each month or each time families' incomes change. Monthly calculations would require MRMIB to acquire and process salary information on a monthly basis, creating substantial administrative complexity. In addition, families who receive the credit may need to submit monthly salary and income data to MRMIB and could pay different amounts for their health premiums every month, leading to confusion and errors.

Proposed Credit Could Create an Incentive for Employers to Drop Health Coverage

The Governor's proposed credit could give employers an incentive to stop providing coverage because workers could only receive the credit if their employers do not offer them coverage. Some workers with job-based coverage may pay less if they could enroll in coverage through the pool and receive the tax credit – particularly workers who currently pay a substantial amount for their coverage. As a result, employers with many workers who might benefit from the credit could act in their workers' best interest if they discontinue health coverage. If employers drop coverage, many workers who are not eligible for the credit – because they have higher incomes – would either become uninsured or be forced to purchase coverage on their own without a subsidy.

Conclusion

The proposed tax credit aims to make health care affordable for families who would not be eligible for the direct premium subsidies proposed by the Governor. However, relatively few California families would benefit from the credit because the proposal narrowly targets families who buy coverage through the new purchasing pool, excluding families with job-based coverage. Many families receiving the credit would have total health costs that exceed 5 percent of their income because the tax credit would only apply to the cost of very basic coverage. Finally, the credit would give employers an incentive to stop offering coverage to their workers.

David Carroll prepared this Budget Brief. The California Budget Project (CBP) was founded in 1994 to provide Californians with a source of timely, objective, and accessible expertise on state fiscal and economic policy issues. The CBP engages in independent fiscal and policy analysis and public education with the goal of improving public policies affecting the economic and social well-being of low- and middle-income Californians. General operating support for the CBP is provided by foundation grants, individual donations, and subscriptions. Please visit the CBP's website at www.cbp.org.

ENDNOTES

[1] The bill language for the Governor's health reform proposal outlines the intent to establish such a credit effective January 2010, but would not actually create the credit. In addition to the tax credit, the Governor proposes direct subsidies for families with incomes below 250 percent of the poverty line who purchase coverage through the new purchasing pool.

[2] Adjusted gross income is the income families report for tax purposes.

[3] Ken Jacobs, et al., *Health Coverage Expansion in California: What Can Consumers Afford to Spend?* (UC Berkeley Labor Center and UCLA Center for Health Policy Research: September 2007).

[4] The actual cost of coverage through the purchasing pool has not been determined.

[5] Mark Greenberg, "Next Steps for Federal Child Care Policy," *The Future of Children* 17 (Fall 2007), p. 82.