

President Bush Announces Broad Health Benefits Proposal

President Bush announced new proposals for promoting health coverage during his recent State of the Union address. Although no actual legislation has been introduced, Willis clients have expressed interest in some of the proposals. The health care proposals would generally make it easier for states to expand health insurance coverage by redistributing federal funding, while also establishing new standardized plans intended to make private health insurance more affordable. However, they also build on the current system of employment-based health insurance coverage.

The most significant component of President Bush's health care proposal centers on instituting a federal tax deduction of \$7,500 for individuals and \$15,000 for families who obtain health insurance on their own or through an employer, regardless of the cost of the coverage. The proposal would also include the value of employer-sponsored health insurance in an employee's taxable income. (Most employees are not taxed on the value of their employer-sponsored health insurance under the protection of long-standing, deeply entrenched tax code provisions.) Under the President's proposal, individuals and families with employer-sponsored health insurance plans worth more than the planned allowable deductions would pay taxes on the difference.

The tax deduction would be available to *all* individuals and families who purchase health insurance, regardless of the value of their policies or whether they itemize deductions on their tax returns. Although there is some uncertainty about how the new tax program would affect people who do not have any tax liability due to low income or unemployment, some legislative observers anticipate that for the proposal to succeed such individuals would receive a refundable tax credit. For taxpayers that receive employer-based health insurance, the deduction would be offset by the cost of their coverage. News reports following the address seemed to indicate that the planned tax changes are intended to have a neutral tax impact over the first ten years following implementation.

Key features of the Administration's tax proposal for health benefits include the following:

- Families with health insurance would pay no income or payroll taxes on the first \$15,000 of compensation and individuals with self-only coverage would pay no income or payroll taxes on the first \$7,500 of compensation. These standard deduction amounts would apply to health coverage obtained in both the individual insurance marketplace and under employer-sponsored plans.
- Taxpayers with employer-sponsored health coverage would be subject to income and payroll taxes on the cost of any health insurance coverage above the standard deduction limits.
- Taxpayers with employer-sponsored coverage would be required to include the total premium cost of health coverage (both the employer and employee share) in their earnings for tax purposes.
- For self-insured employer plans, the total premium would be determined based on the methodology for determining premiums for COBRA coverage.
- Employers would also be required to pay the employer share of payroll taxes on the cost of health insurance above the standard deduction limits.
- Employers would continue to be able to take a full deduction for their health insurance

expenses, including for any additional payroll tax expense resulting from the payment of the employer share of FICA tax on the cost of health insurance above the standard deduction limits.

- Taxpayers whose health insurance costs less than \$15,000 for family coverage or \$7,500 for self-only coverage would still be able to claim the entire standard deduction amount.
- The standard deduction amounts would not be phased out for higher earner taxpayers.
- Taxpayers would be required to obtain at least catastrophic health coverage in order to claim the standard deduction for tax purposes. Catastrophic coverage would be broadly defined in order to provide flexibility in the marketplace to offer such coverage and Bush Administration officials have stated that details on the definition of catastrophic coverage will be provided at a later time.

- Employees would no longer be permitted to pay for health insurance coverage and qualified health expenses on a pre-tax basis under Section 125 cafeteria plans and medical flexible spending arrangements (FSAs) would also be eliminated.
- The standard deduction amounts would be indexed in the future to the consumer price index (CPI) rather than to health care costs which tend to increase at a higher rate than the CPI.
- Current law rules for health savings accounts (HSAs) would not be altered and employer contributions to HSA accounts would continue to not be considered taxable income to an employee.

Further information about the President's health proposal has been posted on the White House's website: <http://www.whitehouse.gov/stateoftheunion/2007/initiatives/index.html>

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