

# Background

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## The Baucus Individual Health Insurance Mandate: Taxing Low-Income and Moderate-Income Workers

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**Abstract:** *The individual mandate in the Baucus health care plan would impose punitively high, regressive taxes on low-income and moderate-income working families. Its penalties and additional taxes on business would discourage companies from hiring or continuing to employ low-income and moderate-income workers. The plan would substantially raise health insurance premiums. Yet the plan would still leave millions of Americans without access to affordable health insurance. Adding to their misfortune, it would then punish them with a tax penalty precisely because they are uninsured.*

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A key component of the health care plan released by Senator Max Baucus (D-MT) on September 16 is its individual mandate—a legal requirement that nearly every American obtain health insurance or face substantial tax penalties.

The mandate would be implemented through new requirements for employers, a new system of state-based health insurance exchanges, and the IRS, which will impose tax penalties on the uninsured and share personal financial data with employers and health insurance companies.

While making health coverage available to all Americans is an admirable goal, the structure of this particular mandate severely restricts customer choice and imposes a punitive and regressive financial burden on those with the least ability to pay. In effect, the Baucus plan would tell the working poor: “If you have been choosing between food and health insur-

### Talking Points

- The Baucus health care plan would impose punitively high, regressive taxes on low-income and moderate-income working families, substantially increase health insurance premiums, and impose financial penalties on those who cannot afford insurance.
- Penalties and additional taxes on business would discourage companies from hiring or continuing to employ low-income and moderate-income workers.
- The Baucus plan would impose new taxes on those who use medical devices and prescription drugs and would raise taxes on those with high medical expenses—effectively taxing the sick to subsidize insurance for the healthy.
- Under the new system, the income of employees’ other family members would be disclosed to their employers, and personal financial data of many Americans would be disclosed to their health insurance companies.

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This paper, in its entirety, can be found at:  
[www.heritage.org/Research/HealthCare/bg2325.cfm](http://www.heritage.org/Research/HealthCare/bg2325.cfm)

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ance, you no longer have that choice. You must buy the health insurance, and we will decide what kind of health insurance you will buy and how much you will pay for it.”

### **The Individual Mandate and the Tax Penalty**

Under the plan, almost everyone who is not covered by a government health program would be required to purchase health insurance starting in 2013. The documents that Senator Baucus has released do not specify the coverage requirements except in the vaguest terms, so accurately estimating the premium cost is not yet possible. Pending amendments suggest that no coverage requirements will be specified in final legislative language and the details will be left to the discretion of appointed officials after the bill is passed.

However, it is clear that almost everyone will be required to obtain coverage, and most will be required to pay for it. The mandate will apply to all adults on behalf of themselves and their dependents under age 18. The mandate will apply to 18-year-olds, even if they are still in high school and unable to secure a full-time job without dropping out. The plan would make exceptions for religious objectors, for undocumented aliens, and possibly in some “hardship” cases if approved by the Secretary of Health and Human Services. However, everyone else would be required to purchase insurance chosen by their employer or approved by a state government-sponsored “exchange.”<sup>1</sup>

Those who do not purchase insurance would face a heavy annual tax penalty. Those with incomes

between one and three times the federal poverty level (FPL) would face a penalty of \$750 per person up to \$1,500 per family. This penalty could apply to individuals with incomes as low as \$10,831 per year. The penalty for those with incomes above three times FPL would be \$950 per person with a maximum of \$3,800 per family.<sup>2</sup>

### **Implementing the Mandate**

Those who do not qualify for government health plans or have access to an employer-sponsored health plan would be required to purchase coverage through a state-sponsored “exchange.” (It would be possible to purchase health plans outside the exchanges, but plans would have to meet all requirements of the exchange regardless of how they are purchased.) Employees who are offered only single coverage at work would be required to purchase coverage for their dependents under age 18. Otherwise, they would pay the tax penalty.

People whose employers offer health plans would be required to enroll in their employer’s plans, unless they can prove that they are already covered through a government program or a family member’s employer-based plan. This would force most employees to choose only plans offered through their workplaces.

The Baucus plan makes an exception for employees whose share of the premium exceeds 13 percent of their family income (not just income from that employer).<sup>3</sup> They would be permitted to opt out of their employer’s plan and purchase insurance, perhaps receiving an income-based subsidy if they purchase through the exchange.

1. Individual and small-group plans sold outside the exchanges would be required to meet the same requirements as plans sold through the exchanges, and all insurers would be required to offer plans through the exchanges. However, only plans sold to individuals through the exchanges would be eligible for the subsidies described below.
2. A proposed amendment would cap the maximum penalty at \$1,900 per family.
3. According to the initial Chairman’s Mark issued on September 16, this exception would almost never apply in practice because premiums paid on a pre-tax basis are not included in the 13 percent and almost all employer-sponsored plans are paid on a pre-tax basis. However, an amendment proposed as part of the modification issued on September 22 changed this so that the employee’s share would count as paid by the employee even if paid on a pre-tax basis. Committee on Finance, U.S. Senate, “Chairman’s Mark,” September 22, 2009, p. 31, at [http://finance.senate.gov/sitepages/leg/LEG%202009/091609%20Americas\\_Healthy\\_Future\\_Act.pdf](http://finance.senate.gov/sitepages/leg/LEG%202009/091609%20Americas_Healthy_Future_Act.pdf) (September 23, 2009), and “Modifications to the Chairman’s Mark: ‘America’s Healthy Futures Act of 2009,’” September 22, 2009, p. 7, at <http://finance.senate.gov/sitepages/leg/LEG%202009/092209%20Modifications%20to%20the%20Chairman%27s%20Mark%20Final.pdf> (September 23, 2009).

Families with incomes below four times the FPL that are ineligible for Medicaid (roughly, those with incomes between \$29,330 and \$88,200 for a family of four) would be eligible for premium subsidies in the exchange. The subsidy is calculated so that the net cost of a standard plan (details unspecified) with an actuarial value of 70 percent (70 percent of what is unspecified) would range from 3 percent of income at the lower end (1.33 times FPL) to 13 percent of income for those with incomes between three and four times the FPL.<sup>4</sup> These subsidies would not be available to those with access to employer-sponsored insurance, except in the case described above. In companies with more than 50 employees that do not offer employer-sponsored insurance, the average cost of the premium subsidy<sup>5</sup> would be charged back to the employer as a tax—a portion of which would be inevitably passed on the employee in the form of lower wages.

## Taxing the Sick

The Baucus proposal includes several provisions that will impose higher taxes on taxpayers who need more health care, regardless of income level. It imposes an “Annual Fee on Manufacturers and Importers of Medical Devices,” which amounts to an excise tax on all medical devices priced over \$100, including everything from wheelchairs and walkers to pacemakers, hearing aids, and MRI scanners.<sup>6</sup> There is a similar annual fee on health insurance companies, clinical laboratories,<sup>7</sup> and manufacturers and importers of branded drugs. All of these annual fees would be passed on to consumers in the form of higher prices and, in the case of devices and drugs covered by insurance, in the form of higher insurance premiums.

These annual fees (that is, taxes) total over \$13 billion and would be allocated according to market

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### ***The Baucus proposal would tax the sick to subsidize insurance for the healthy.***

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share.<sup>8</sup> Yet the true impact would be higher because the taxes paid would be treated as profit for corporate income tax purposes. The results could increase the effective tax to as much as \$17.6 billion. This may result in money-losing companies paying tax on “profits” they do not actually have.

Some provisions tax those who need health care, but only if they make enough to pay income taxes. For example, it would reduce the cap on income that can be placed tax-free into a Flexible Spending Account (FSA or “cafeteria plan”) from \$5,000 to \$2,000.<sup>9</sup> In addition, it would raise the threshold for itemized deductions of medical expenses from 7.5 percent of income to 10 percent, further penalizing those with high medical expenses not covered by insurance.

Another provision would increase the threshold for deducting excessive medical expenses for income tax purposes. Currently, medical expenses (other than those paid pre-tax through an employer) that exceed 7.5 percent of adjusted gross income are deductible. The Baucus proposal would raise this threshold to 10 percent. This would raise taxes on more than 6 million households that face high health care costs, about half of which have incomes low enough that they would qualify for the subsidies these taxes are intended to pay for.<sup>10</sup>

The revenue from these taxes is intended partly to offset premium subsidies for households with incomes below four times the FPL, but these taxes would be imposed on Americans who need medical devices or prescription drugs, have high out-of-

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4. A proposed amendment would change this range to 2 percent to 12 percent.

5. This tax has a per-company cap of \$400 per full-time employee.

6. The exemption for devices that cost less than \$100 is in a proposed amendment.

7. An amendment may remove the fee for clinical laboratories.

8. It would cost \$12.3 billion if the tax on clinical laboratories is dropped.

9. A proposed amendment would set the cap at \$2,500.

10. Authors’ calculations based on the Center for Data Analysis Individual Income Tax Model. The projection is for year 2014, the first full year the Baucus plan would be in effect.

pocket costs, or pay their own health insurance premiums. In effect, the Baucus proposal would tax the sick to subsidize insurance for the healthy, and many of the taxes would be imposed on the same people “helped” by the subsidies.

### Taxing Low-Income Workers

The Baucus proposal imposes a partially hidden, substantial tax burden on those who can least afford to pay. First, workers offered insurance through their employer on a pre-tax basis would be required to purchase it, unless their share of the premium exceeds 13 percent of income.<sup>11</sup> This could impose substantial hardships on low-wage workers in companies with generous (i.e., “expensive”) health plans. Because employers are required by law to offer the same health insurance options to all full-time employees, low-income workers in mostly high-paying companies (for example, support staff at a law firm) would be at a substantial disadvantage. They could be required to purchase insurance designed and priced for upper-income people, even if the premium nearly exhausts their paychecks.

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***More than 570,000 families that pay no income tax or are in the 10 percent income tax bracket would be subject to this punitive 35 percent tax on “excessive” health benefits.***

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For example, someone who earns \$15,080 per year before taxes by working 40 hours per week at the minimum wage could be required to pay \$1,960 for a generous individual health plan or even more for a family plan. A minimum-wage worker could be required to pay almost 20 percent of his or her income in payroll taxes and mandatory health insurance. This employee would not even have the option of declining the health insurance and paying the \$750 penalty, since employees would not be

allowed to opt out of their employer plans unless they could prove they had other insurance. In effect, the worker would be forced to buy an expensive health insurance plan instead of other necessities, such as food and rent.

Furthermore, if the value of the employer-offered plan exceeds \$8,000 for an individual or \$21,000 for a family,<sup>12</sup> the employee would be subject to a 35 percent excise tax on the amount above those limits. This tax rate is much higher than the income tax rates that most families pay on regular income. Figures from the Current Population Survey and the Medicare Expenditure Panel Survey show that more than 570,000 families that pay no income tax or are in the 10 percent income tax bracket would be subject to this punitive 35 percent tax on “excessive” health benefits. More than 7.2 million households—almost 94 percent of those paying the excise tax—would pay higher taxes on their health insurance than on their income.<sup>13</sup> Of course, because purchasing the insurance would become mandatory, those numbers could become even higher if this proposal becomes law. (See Chart 1.) A full-time minimum-wage worker with a generous employer-paid plan could be forced to pay hundreds of dollars in excise tax even if the employer paid the entire health care premium.

An amendment proposed by six Democrats on the Senate Finance Committee—which Chairman Baucus has recommended accepting—would make the excise tax 40 percent instead of 35 percent. If this were adopted, *all* affected taxpayers would pay a higher tax rate on health insurance than on regular income.

A worker whose share of the premium for employer-based insurance exceeded 13 percent of family income could opt out and purchase insurance through the exchange, but this would generate a hefty tax bill for the employer, which would either

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11. This assumes passage of the amendment changing the treatment of pre-tax premium payments. (See Footnote 2.) Otherwise, they would be required to buy it regardless of premium.

12. An amendment proposed by six Finance Committee Democrats and accepted by Chairman Baucus would provide slightly higher limits for retirees over age 55 and those engaged in “high-risk” professions.

13. Authors’ calculations using data from the 2008 Current Population Survey and the 2001–2003 Insurance Components of the Medical Expenditure Panel Survey.

be passed on to the employee in the form of lower pay or endanger the employee's job.<sup>14</sup>

Low-income and moderate-income workers who purchase health insurance through the exchange rather than through an employer would be in a different, yet potentially more oppressive situation. Companies with more than 50 employees that do not offer health plans would pay a special tax to "reimburse" the government for the premium subsidies provided to their employees through the exchange. This tax would add to the cost of hiring and retaining these employees, and the money would have to come from somewhere.

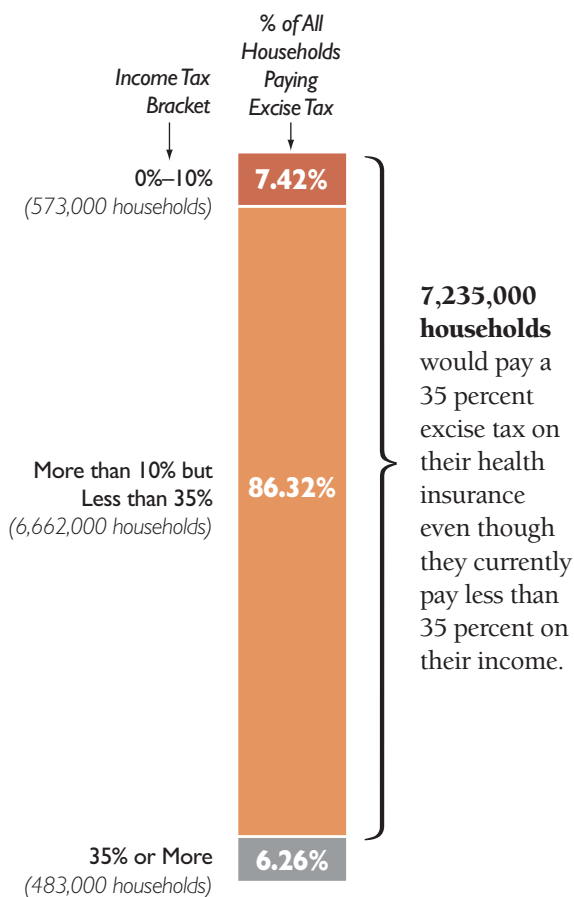
Businesses do not have unlimited funds to dole out based on their own beneficence or the government's instructions. They must pay all employment-related costs out of payments received from customers for their employees' work. To pay the taxes to subsidize health insurance for their employees, they would likely be compelled to reduce the pay of those same employees—in effect, making the employees pay for their own subsidies. Even worse, employers who lack enough revenue to pay minimum wage plus the cost of other benefits and the new taxes would be forced to lay off their lowest-paid employees to comply with the law.

Curiously, the tax will not affect all employers equally. Each employer's tax would be the total cost of the subsidies for its low-income and moderate-income employees or \$400 for each full-time employee, whichever is less. For an employer with mostly low-income employees, hiring another would increase taxes by only \$400. However, an employer with mostly high-income employees would pay a tax equal to the average subsidy in the exchange to hire a low-income employee. This average would be calculated annually and would likely amount to thousands of dollars. At the margin, the penalty would be the harshest for companies with many higher-income employees who hire or continue to employ lower-income support staff. The inevitable result would be that these companies would lay off lower-income workers or reduce their hours to less than full-time, and companies with mostly low-income employees would be

## The Baucus Excise Tax Will Hit Mostly Low- and Middle-Income Earners

Under the Baucus health care bill, more than 7.7 million households in the U.S. would face a 35 percent excise tax on their health insurance. As a result, nearly 94 percent of those households would pay a higher tax rate on their health insurance than on their income.

### Affected Households, by Income Bracket



**Note:** An amendment proposed by six Democrats on the Senate Finance Committee—which Chairman Baucus has recommended accepting—would make the excise tax 40 percent instead of 35 percent. If this were adopted, all affected taxpayers would face a higher tax rate on health insurance than on regular income.

**Source:** Heritage Foundation calculations using data from the 2008 Current Population Survey and the 2001–2003 Insurance Components of the Medical Expenditure Panel Survey.

Chart 1 • B 2325 [heritage.org](http://heritage.org)

14. This assumes passage of the amendment changing the treatment of pre-tax premium payments.

forced to downsize or cut wages to make up for the new taxes.

The Baucus plan would have another, even stranger effect on hiring. Because the subsidy amount is based on family income and family size, not the wages that the employer pays, employers would naturally prefer to hire workers from higher-income families with fewer children. For example, hiring a single parent could incur a substantially higher tax penalty than hiring a worker with a working spouse or parent(s), or a worker who is single and childless. Business would be discouraged from hiring those who need the jobs the most.

### **Mandatory Loss of Privacy**

Taxing employers based on employees' family income would require informing companies of their employees' family incomes from other sources. Employers would have to be provided with this information so they would know how much tax to pay, even if their employees do not want to provide the information. Furthermore, employers could use this information to discriminate against workers from low-income families—precisely the people who need the jobs the most.

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***Employers would be penalized for hiring those who need jobs the most.***

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In addition, subsidies provided in the exchange would be transferred by the federal government directly to insurance companies, who would bill policyholders only for the remaining premium, based on income. To make this system work, health insurers would need to be provided with information on the family income of their policyholders, even if those policyholders wish to keep that information private.

To enforce these provisions, the bill would therefore require individuals, health insurers, employers, and government health agencies to report detailed

health insurance information on all Americans to the IRS, adding significant administrative costs and reducing privacy protections. The IRS would also be required to report personal income data to state exchanges, insurance companies, and employers because premium credits and out-of-pocket limits would depend on income.

### **The Effect of the Baucus Proposal**

The net result is unambiguous: The Baucus proposal would impose punitively high, regressive taxes on low-income and moderate-income working families—those with the least ability to pay. It would also subject them to lower incomes, job losses, and reduced job opportunities. While the families with the lowest incomes will be hit hardest, moderate-income families would also suffer from higher taxes and lower incomes. Yet even at this high price, millions of Americans would still be left without health insurance, and the plan's tax penalties would further punish these uninsured for their misfortune.

Meanwhile, all Americans, even those who can afford the higher premiums and higher taxes, would suffer needless invasions of their privacy as they are forced to reveal the income of other family members to their employers and provide private, personal financial information to their health insurance companies.

America does not need health care “reform” that increases premiums and taxes and punishes the less fortunate. Americans need reform that increases choices and options, eliminates regulations that needlessly increase costs, protects privacy, and empowers individuals and families to make their own decisions and control their own health care.

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