Tax Fairness at Work

Under the Sessions/Cassidy bill, for the first time in history people will get the same tax relief for the purchase of health insurance regardless of income and regardless of where they obtain it – at work, in an exchange or in the marketplace. Self-insured employers will have the option of being grandfathered under the current system. But we believe that almost all employers will choose the tax credit option once they evaluate the alternatives.

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All people will get the same tax relive for the purchase of health insurance under the Sessions/ Cassidy bill.

All employers will be required to report the amount spent on health insurance for each employee and the amount that was spent with pre-tax dollars (both by the employer and the employee) on the employee's W2 Form – which is mainly what they are already required to do under ObamaCare.

Employers in the tax credit system will face four additional alternatives:

- They may purchase insurance with pre-tax dollars – just as they do today. However, employees will not be allowed to double dip. On their tax returns, their tax subsidy will be topped up or clawed back to insure that their net tax relief will be equal to the allowed tax credit amount – for example, $2,500 for an adult and $1,500 for a child in 2017.
- They may purchase insurance with after tax dollars. In this case, employees will be able to claim the tax credit on their income tax returns.
- For low-income employees, the employer may ask the employee to assign the credit to the employer, who may take advantage of the fact that the credit is advanceable and transferable, just as an insurance company does under ObamaCare. This helps cash flow.
- For low-income employees, the employer may offer limited benefit insurance and receive the advanceable partial tax credit.

Let's consider the first bullet and walk through the mechanics of how it works. As a last step in the preparation of an employee's income tax return, tax preparers today (including, for example, H & R Block) calculate the taxpayer's marginal federal income tax rate. To this they will be expected to add the taxpayer's marginal payroll tax rate (which for most will be 15.3%) to obtain a total marginal tax rate (TMTR). The taxpayer's implicit tax subsidy is the amount spent on health insurance with pre-tax dollars times the TMTR. If the implicit subsidy is less than the tax credit amount, the taxpayer will receive a reduction in taxes. If the implicit subsidy is more than the tax credit amount, the taxpayer will owe additional taxes.

Here are some examples:

Case 1:

Thomas obtains health insurance at his place of work and he and his employer spend $5,000 in pre-tax dollars on the premiums. Since Thomas' federal tax rate is 15% and his (employer + employee) FICA tax rate is 15.3%, his TMTR is 30.3%. Therefore his implicit subsidy is $1,515. Since he is entitled to a $2,500 tax credit, Thomas will be able to get a refund or reduce his taxes owed by $985.

Case 2:

Mary obtains family coverage from her employer that covers her husband and two children. She and her employer obtain the insurance by paying $20,000 with pre-tax dollars. Mary's federal income tax rate is 25% and she and her employer are paying a combined FICA tax of 15.3%. Her TMTR is 40.3% and her implicit subsidy is $8,060. Since the maximum tax benefit is $8,000 for a family with two adults and two children, Mary will owe an additional $60 in taxes.

Case 3:

Brenda and Joe are married. They each work for a high tech firm that pays them high wages and provides them with pre-tax health insurance benefits that cost $6,000 each. The couple has a marginal federal tax rate of 39.6%. Because of their high incomes, both individuals have maxed out on their Social Security payroll taxes. However they are paying a Medicare tax of 3.8%. So their TMTR is 43.4% and their implicit subsidy is $2,604. Since their tax benefit for health insurance is limited to $2,500, they each will owe additional taxes of $104 or $208 on a joint return.

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