



Health Policy Brief

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Premium Tax Credits. Low- and middle-income individuals and families will be eligible for federal subsidies to purchase insurance through the new exchanges.

WHAT'S THE ISSUE?

Beginning January 1, 2014, the Affordable Care Act (ACA) requires most Americans to be insured under a public or private health plan or be subject to a tax penalty. To make insurance affordable for low- and middle-income individuals and families not otherwise eligible for public or employer-sponsored coverage, the ACA provides subsidies in the form of tax credits for private health insurance purchased through newly established health insurance exchanges.

The federal government and the states are now engaged in intense efforts to implement the requirements of the ACA so that enrollment can begin on October 1, 2013, with coverage and subsidies beginning in January 2014. The extent to which eligible individuals learn about, understand, and take advantage of the subsidies will be critical to the exchanges' success or failure. As of July 2013, there is considerable confusion among the public regarding the insurance mandate, the qualifications for subsidies, and the process for enrolling in a health plan and obtaining the subsidies.

Major unresolved issues around the ACA's premium tax credit provisions will begin to play out in the next several months, including the effect that enrollment numbers will have on future premium prices in the individual insurance market, the costs of the subsidies and their impact on the US budget, and the

mechanics of administering a complicated program through the untested exchanges.

WHAT'S THE BACKGROUND?

Most people in the United States with health insurance are covered either through their employment or through a government health insurance program. This will continue to be the case under the ACA. However, almost one in five Americans are uninsured—nearly 48 million people in 2011. The uninsured generally are ineligible for government health programs and do not have access to employer-provided health insurance. To obtain health insurance, these people currently must purchase coverage in the individual health insurance market, where plans typically have less generous benefits than public or employer plans. A study by the Kaiser Family Foundation found that premium costs in the individual market in 2010 averaged more than \$2,500 per person per year across the nation—an amount that is unaffordable for the majority of the uninsured and leaves many with too little coverage.

The federal government has subsidized employer-based health insurance through the income tax system since World War II. Contributions to health benefit plans and direct reimbursements for medical care expenses are excluded from employees' (and retirees') income for tax purposes. This exclusion for employer-provided health care is the single largest tax expenditure under the current tax system, amounting to an estimated \$260

\$5,290

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billion in reduced income and payroll tax revenues in 2013.

Individuals who purchase their own coverage, however, are entitled only to the deduction allowed for unreimbursed medical expenses, including any health insurance premium amounts, to the extent that the expenses exceed 10 percent of their adjusted gross income (AGI), or 7.5 percent for seniors ages 65 and older. For example, a family with an AGI of \$50,000 may deduct annual medical expenses in excess of \$5,000 only. Because most families at this income level have a low marginal tax rate, or may not even itemize deductions, they receive little in terms of a tax benefit.

Since 2002 the Internal Revenue Service (IRS) has had some limited experience with administering tax credits for health insurance. About 500,000 workers who lost their jobs because of foreign import competition and certain retirees who lost their pensions from their former employers and are now paid by the Pension Benefit Guaranty Corporation are eligible for the Health Coverage Tax Credit (HCTC), a refundable tax credit for health premium costs. The HCTC program, however, has experienced substantial problems, including low participation among the eligible and high administrative costs.

To address the low participation in the HCTC program, Congress increased the amount of the credit from 65 percent of premium costs to 72.5 percent in 2009, but still only about 10 percent of those eligible participate. The IRS continues to make operational changes to improve administration of the program. The HCTC program expires at the end of 2013 when the tax credit subsidies become available for individuals under the ACA.

WHAT'S IN THE LAW?

The ACA calls for the establishment of American Health Benefit Exchanges in every state that will function as a marketplace, offering a variety of health plans to citizens and lawfully present immigrants. Health plans offered through the exchanges must meet minimum federal standards and will provide different levels of coverage that correspond to specific actuarial values—that is, the average percentage of health care costs covered by the plan: bronze (actuarial value of 60 percent), silver (70 percent), gold (80 percent), and platinum (90 percent).

To help make premiums affordable, federal subsidies in the form of tax credits will be available for eligible individuals and families who purchase insurance through an exchange (see “Eligibility for Subsidies” below). The tax credits are refundable, which means that eligible taxpayers receive the full amount of the credit, regardless of how much they otherwise owe in federal income taxes. The Congressional Budget Office (CBO) estimates that in fiscal year 2014, 7 million people will obtain coverage through the exchanges—6 million of whom will receive premium subsidies. By fiscal year 2023, the number of people obtaining exchange coverage will rise to 24 million—with 19 million receiving premium subsidies. The premium tax credit subsidies are estimated to cost the federal government \$16 billion in outlays and \$3 billion in reduced revenues in fiscal year 2014, rising to \$115 billion in outlays and \$16 billion in reduced revenues in fiscal year 2023, the tenth year.

In addition to the premium tax credit subsidies, cost-sharing subsidies will be available to individuals and families with incomes up to 250 percent of the federal poverty level who purchase a silver plan through an exchange. The cost-sharing subsidies reduce deductibles, coinsurance, and copayments for covered services such that those with the lowest incomes would pay only 6 percent of covered health care costs, scaling up to 27 percent for those at 250 percent of poverty.

In total, CBO estimates that the federal government will spend \$5,290 per subsidized enrollee in fiscal year 2014, rising to \$7,900 in fiscal year 2023. This includes spending for premium tax subsidies; cost-sharing subsidies; and, through 2014, related federal financial support to operate the exchanges.

ELIGIBILITY FOR SUBSIDIES: Individuals are eligible for the premium tax credits if (1) they are not eligible for employer-provided coverage or for a public health insurance program; (2) they are US citizens or lawful residents of the United States; (3) they are not incarcerated; and (4) their modified AGI is 100–400 percent of poverty (about \$11,500–\$46,000 for an individual and \$23,000–\$94,000 for a family of four in 2013). Lawfully present immigrants with incomes below 100 percent of poverty are also eligible if they do not qualify for Medicaid because of immigration status (for example, if they arrived in the United States during the past five years). To be eligible, individuals must file a federal tax return in 2015 (a joint return if married) and not be claimed

as a dependent on anyone else's return. The premium tax credit can be used to purchase coverage for all people claimed as dependents on the tax return.

The ACA includes an exception that allows individuals with access to employer-provided coverage to instead purchase coverage through an exchange and receive a premium tax credit if their employer-provided coverage is "unaffordable" or does not provide minimum value. The ACA defines unaffordable as worker-only coverage that costs more than 9.5 percent of household income, even in cases where an employee wishes to obtain family (not worker-only) coverage. Minimum value is defined as coverage of at least 60 percent of medical-benefit costs. The ACA requires large employers (50 or more employees) to pay penalties if their full-time employees receive premium tax credits for coverage obtained through an exchange. Because of the complexities of implementing this provision, the Obama administration recently delayed such penalties until 2015.

AMOUNT OF CREDIT: The premium tax credit will vary based on family income and the cost of health insurance in the exchange available to the taxpayer. The credit will equal the difference between the premium for the second-lowest-price silver plan (also known as the benchmark plan) and a specified percentage of income. In 2014 the percentage ranges from 2 percent for those with incomes below 133 percent of poverty and scales up to 9.5 percent for those with incomes up to 400 percent of poverty (see Exhibit 1). The percentage will be adjusted in subsequent years to account for any excess in the rate of premium growth over the rate of income growth.

The benchmark plan is used only for determining the amount of the tax credit. Individu-

als may apply the credit to any plan available in the exchange and pay the difference between the credit and the premium for their plan of choice. It is possible, therefore, for exchange participants receiving tax credits to pay no premium for coverage if they choose a plan with a premium substantially lower than the benchmark or to pay more than the percentage of income indicated on the table in Exhibit 1 for a plan more costly than the benchmark. They would never pay less than zero dollars, however.

For example, the Smith household consists of a couple with two children. Their income is \$47,100, placing them at 200 percent of poverty. The annual premium for the second-lowest-price silver plan available to them in the exchange is \$10,000. The amount of tax credit they will receive is \$10,000 less \$2,968 (6.3 percent of \$47,100), or \$7,032. They chose to enroll in a plan offered by the exchange with an annual premium of \$9,000. As a result, they will pay \$1,968 a year (\$164 per month) for their premium, and the IRS will send the insurer \$7,032 a year (\$586 a month).

ADVANCED PAYMENT: Ordinarily, tax credits are claimed after the end of the year on a federal tax return. Because most low- and moderate-income people who will qualify for health insurance tax credits are unable to "front" the full premium cost based on the expectation of tax refunds after the end of the year, these tax credits can be "advanced" each month and paid directly to insurers when premiums are due. The advance payment of a tax credit is based on the consumer's anticipated annual income. A reconciliation based on actual income takes place after the end of the year through the annual income tax filing process. If the Smith family's income (or other circumstances, such as family size) changes from that which was used to estimate the credit amount, the family will either get a refund or have to repay any excess amount up to \$1,500, the maximum amount for their income level (see Exhibit 2).

The ACA places limits on any such liability for those with annual incomes, as reported on tax returns, below 400 percent of poverty. Taxpayers with incomes above this level must repay the entire amount of any overpayment. Congress has lifted the repayment caps twice since enactment of the ACA. The current repayment caps are as follows.

ADMINISTRATION OF THE PREMIUM TAX CREDITS: The premium tax credits will be administered by the IRS and Department of Health and

EXHIBIT 1

Individual Responsibility for Premium Costs in Premium Tax Credit Calculation

Income level as percentage of federal poverty level	Premium costs as a percentage of income, 2014
Less than 133%	2
At least 133% but less than 150%	3-4
At least 150% but less than 200%	4-6.3
At least 200% but less than 250%	6.3-8.05
At least 250% but less than 300%	8.05-9.5
At least 300% but less than 400%	9.5

SOURCE Federal Register, "Internal Revenue Service; Health Insurance Premium Tax Credit; Final Regulations," May 23, 2012.

\$16 billion

In federal outlays

The federal government is estimated to spend \$16 billion on premium subsidies in fiscal year 2014.

Human Services through the exchanges. Individuals can apply for the credits and enroll in a plan during the exchange open-enrollment periods. The first open-enrollment period begins October 1, 2013, for coverage that starts January 1, 2014. Tax credit amounts will be determined using the most recent income tax filing or other information if a tax form wasn't filed for 2012.

If income is expected to be substantially different from the previous year, other documentation, such as current pay stubs, may be used to estimate expected annual income. However, exchanges must use federal tax and social security data systems to determine eligibility whenever possible rather than request documentation from consumers. If data matches cannot verify income within a day of the application, advance payment of tax credits can be based on the consumer's attestations, subject to later tax reconciliation if annual income differs from those attestations.

Most beneficiaries are likely to take their credits in advance, and the IRS will make direct monthly payments to the insurer, leaving the beneficiaries liable for the premium portion not covered by the credit. However, consumers can reject advance payment or take less than the full amount in advance, thereby reducing the chances of repayment and deferring more of the tax credit until tax filing time.

WHAT'S THE DEBATE?

The law's proponents are focused on the need for public education and application assistance to encourage enrollment. According to an April 2013 tracking poll by the Kaiser Family Foundation, most people are ignorant or confused about the ACA, and about half of respondents feel that they do not have enough information to understand how the law will affect their own families—a concern even

more prevalent among uninsured and low-income households. Most uninsured people who qualify for assistance are unaware that the ACA will help them afford coverage. But a recent study from Consumers Union showed that explaining the subsidy to consumers in simple terms increases the number of people who are interested in taking advantage of the new benefit.

There are also concerns about factors that may make the subsidies less attractive to consumers, such as the complexity of determining eligibility and computing the amount of subsidy, which are likely to reduce participation levels. Noting that successful enrollment often requires avoiding paperwork by having providers or community groups complete applications on consumers' behalf, many observers fear that such assistance is inadequately funded, particularly in states with federally facilitated exchanges. Some also worry that premium costs, even after subsidies, may deter enrollment of low- and middle-income consumers, given the small penalties that attach to uninsurance and the limited enforcement of such penalties. It is also not clear whether the possibility of losing tax refunds or incurring debts to the IRS (if the initial estimated credit exceeds the final determination) will discourage consumers from using the advance payment feature.

Critics of the law are concerned about the costs of the federal government subsidies and their effect on the nation's fiscal health. They point to the fact that the subsidies are an open-ended entitlement, not subject to the annual congressional appropriations process, and that by 2017 the subsidies will be the nation's fifth largest tax expenditure. There is also concern that the cost projections may be underestimated, noting that President Barack Obama's budget has substantially increased the estimated costs of the subsidies in each of the last three fiscal years.

CBO's estimates, on the other hand, have changed little since the ACA was enacted. The administration and supporters of the law's insurance coverage provisions point to the new revenues and expenditure reductions included in the ACA that will largely offset the subsidy costs.

They also note that although not recognized in CBO's accounting, additional savings may be realized from other ACA provisions that will make the US health care system more equitable and efficient, such as paying provid-

EXHIBIT 2

Limits on Repayment of Excess Premium Tax Credits

Income level shown on annual tax return	Maximum amount of repayment	
	Individual	Family
Less than 200% FPL	\$300	\$600
At least 200% but less than 300% FPL	\$750	\$1,500
At least 300% but less than 400% FPL	\$1,250	\$2,500
400% FPL or greater	Entire amount of overpayment	

SOURCE Federal Register, "Internal Revenue Service; Health Insurance Premium Tax Credit; Final Regulations," May 23, 2012. **NOTE** FPL is federal poverty level.

“Some worry that premium costs, even after subsidies, may deter enrollment of low- and middle-income consumers.”

ers based on quality of care instead of on the quantity of services provided.

Finally, proponents note that some form of coverage subsidy is critical if everyone is to participate in the insurance system. Other important provisions of the law, such as guaranteed issue and renewal, cannot be successfully implemented unless everyone participates in the insurance system.

WHAT'S NEXT?

The first open-enrollment period for the exchanges is scheduled to begin on October 1, 2013. Outreach by federal government agencies as well as the states will intensify. Prior

to that date, exchanges must be established, qualified health plans approved, navigators and application assisters trained, and the public educated about their new rights and responsibilities.

In addition to the government's efforts, a number of private consumer groups are organizing campaigns for public education and outreach and enrollment, and there are a number of “premium subsidy calculators” available on the internet that can help people estimate the amount of subsidy assistance that will be available to them. At the same time, some opponents of the ACA have announced their intent to mount media efforts to discourage enrollment. ■

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RESOURCES

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