



# John McCain's Radical Prescription for Health Care

## *Plan Would Raise Taxes on Many Middle-Class Families and Fail to Make Insurance Affordable*

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### Introduction and Summary

Sen. John McCain (R-AZ) has proposed a far-reaching plan to fundamentally reshape our health care landscape. The presumptive Republican presidential candidate's plan raises taxes on millions of families—with the largest increases falling on middle-class households—and fails to make insurance affordable for many households, especially low-income families and individuals with pre-existing conditions.

Today, workers with health insurance through their jobs enjoy largely tax-free benefits. McCain's plan treats these benefits like wages, making them subject to income and payroll taxes, and creates a new tax credit for insurance premiums worth \$2,500 for individuals and \$5,000 for families.<sup>1</sup> In the process his plan rewrites well over \$200 billion in health subsidies provided through the tax code—a massive sum that is about three times larger than any Cabinet agency other than the Department of Defense.<sup>2</sup> Our analysis of the dramatic changes McCain proposes reaches three conclusions.

- **For most taxpayers, McCain's tax credit quickly becomes a tax increase.** McCain's new tax credit grows only at the rate of inflation (about 2 percent a year), while current tax subsidies keep up with health insurance premiums (about 7 percent a year).<sup>3</sup> As a result, the value of the tax credit quickly falls behind rising health care costs, meaning most households with employer coverage today would soon see a tax increase. Families earning \$40,000, for example, would receive a small tax cut in 2009, but by 2018 they will be paying over \$2,800 more a year in taxes.
- **Many middle-class households under the McCain plan pay higher taxes immediately.** Households with employer-sponsored coverage, higher incomes, and higher premiums are the most likely to see immediate tax increases. The largest tax increases fall on middle-class families, which pay the highest combined payroll and income tax rates.

- **The “one-size-fits-all” design of McCain’s tax credit is ineffective at making coverage affordable for Americans with low incomes or pre-existing illnesses.** Most uninsured Americans live under or near the poverty line and cannot afford high premiums. By providing the same \$5,000 subsidy to every family, the McCain plan falls far short of the help that low-income families need. It also ignores the higher premiums faced by individuals with existing illnesses, who are approaching middle age, or who live in states with higher medical costs and are likely to find premiums still out of reach.

Reforming the tax treatment of health insurance could be an important part of a broader health care reform effort. A better approach would include larger tax increases on high-income households, effective cost containment, and accessible and affordable coverage options for everyone. The McCain plan instead upends the current health insurance system, increases middle-class taxes, and fails to make coverage affordable and available to everyone.

## Rewriting Tax Subsidies for Health Insurance

Health insurance in the United States has been organized around workplaces from the beginning. Businesses first offered health benefits in the 1930s, and benefits grew more common during World War II due to their exemption from wartime wage controls. In the 1950s, strong unions and favorable tax treatment solidified the link between employment and insurance. Today, 158 million people—the majority of non-elderly Americans—receive insurance from their own or a family member’s job.<sup>4</sup>

### Current Law

Tax benefits continue to provide a strong rationale for employers to offer health insurance. Premiums paid by employers are not subject to either income or payroll taxes. Premiums paid by employees are usually also tax-free.<sup>5</sup>

A typical middle-class worker pays 15 percent in federal income taxes, about 5 percent in state income taxes, and 15.3 percent in payroll taxes (including taxes nominally collected from employers but actually borne by workers).<sup>6</sup> As a result, each additional dollar earned in wages is worth only about 65 cents after taxes. However, a dollar in health insurance premiums is worth a full dollar because it is tax-free. In other words, compensation paid in the form of health insurance is worth nearly 50 percent more than compensation paid as wages.

The tax exemption is a major federal commitment to expanding health insurance. The U.S. tax codes delivers well over \$200 billion a year in subsidies that make insurance more affordable.<sup>7</sup> The tax exemption supports the employer-based system of health care, which (despite its flaws) delivers insurance to the majority of Americans with relatively low administrative costs, and includes people who have existing illnesses or are at a greater risk of developing them.

Reform of the tax exemption could be an important part of broader health care reform legislation. As a method of making insurance affordable, today's tax benefits are "upside down" because they give the most help to the middle-class and high-income households that pay the highest tax rates and offer little help to low-income workers who pay only payroll taxes.<sup>8</sup> Some analysts believe that the tax subsidy encourages people to purchase more coverage than is needed, leading to wasteful health care spending.<sup>9</sup>

### **The McCain Plan**

Sen. McCain's plan repeals the tax exclusion for employer-provided insurance, requiring workers to pay income and payroll taxes on their health benefits. In its place, his plan creates a new refundable health insurance tax credit worth \$5,000 for families, and \$2,500 for individuals.<sup>10</sup> The new credit would be fully funded by repealing the existing health care tax benefits.<sup>11</sup>

The McCain plan's new credit would be available to taxpayers buying insurance individually as well as those who buy it through their jobs. It would be refundable to taxpayers with low incomes who pay little or no income taxes. Families who buy "innovative" policies that cost less than the value of the credit would be able to keep the whole credit by depositing the excess into health savings accounts. Each year, the value of the credit would be adjusted for inflation, growing more slowly than the current tax break for employer-provided health insurance, which grows with health care premiums.<sup>12</sup>

The proposal is similar to one that President Bush proposed in 2007 and 2008.<sup>13</sup> The Bush tax benefit was structured as a deduction rather than a credit, but administration officials indicated that Bush was open to either approach.<sup>14</sup>

While some workers would lose health benefits from their jobs, the standard economic assumption is that these workers would gain higher wages and their overall compensation would not change. The McCain plan's impact on coverage is not yet clear, but some analysts suggest that the proposal is likely to expand coverage. McCain advisors say that 20 million uninsured Americans would gain coverage under the plan, while Emory professor Ken Thorpe estimates that number at 5 million to 7 million.<sup>15</sup>

McCain also proposes a number of complementary health care policies. Most notably, he would encourage the deregulation of health insurance by allowing insurers to sell across state lines to avoid state consumer-protection laws. His health care proposals are available at [www.johnmccain.com](http://www.johnmccain.com).

### **The McCain Plan Would Raise Costs for Many Households**

McCain's advisors describe the effect of the tax changes on workers covered through their jobs as only "accounting on their pay stub."<sup>16</sup> In fact, the McCain plan changes the amount of tax subsidies for insurance for nearly everyone receiving health insurance, either cutting their taxes or raising them. Most households will see a tax increase in the coming years.

One exception is the 14 million households who buy coverage outside of employer-provided insurance plans in the individual, or so-called nongroup, market.<sup>17</sup> These households often get no subsidies today. However, as discussed below, the McCain tax credit is too small to make insurance affordable for many people who need insurance the most. The McCain plan would also deregulate this already lightly regulated market, giving insurers a greater ability to exclude people who have illnesses or are more likely to develop them.<sup>18</sup> Nearly everyone else with health insurance would see higher taxes under the McCain plan. The four main reasons are:

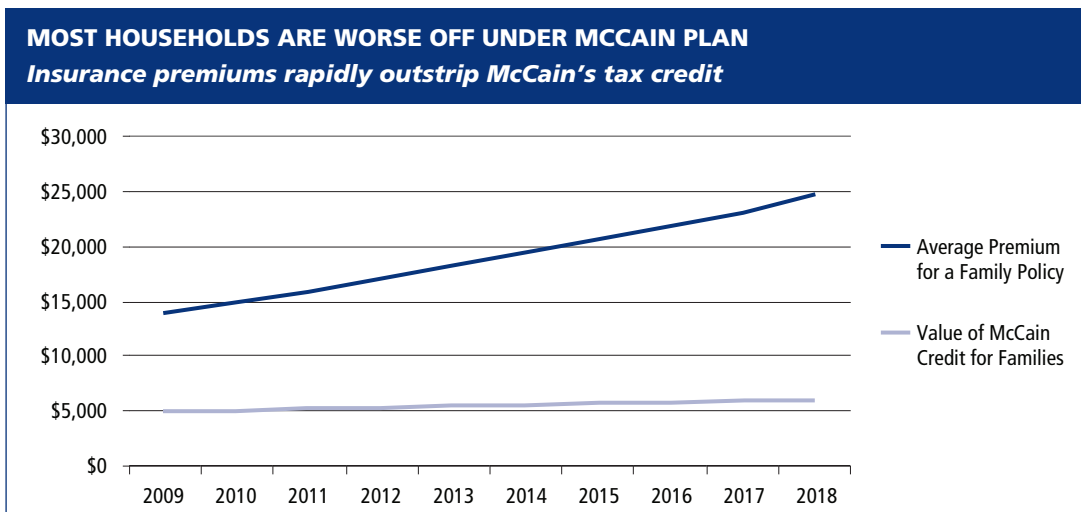
- The tax credit quickly falls behind rising health care costs.
- The largest tax increase falls on middle-class families.
- Middle-class residents of states with higher tax rates see larger tax increases.
- Middle-class residents of states with higher medical costs also see larger tax increases.

***The McCain Credit Quickly Falls Behind Rising Health Care Costs***

The McCain plan is a more of a tax increase than a credit. It limits the growth of the tax credit to the rate of inflation (about 2 percent a year, according to Congressional Budget Office projections).<sup>19</sup> In contrast, current tax benefits grow at the pace of health premiums (7 percent a year).<sup>20</sup>

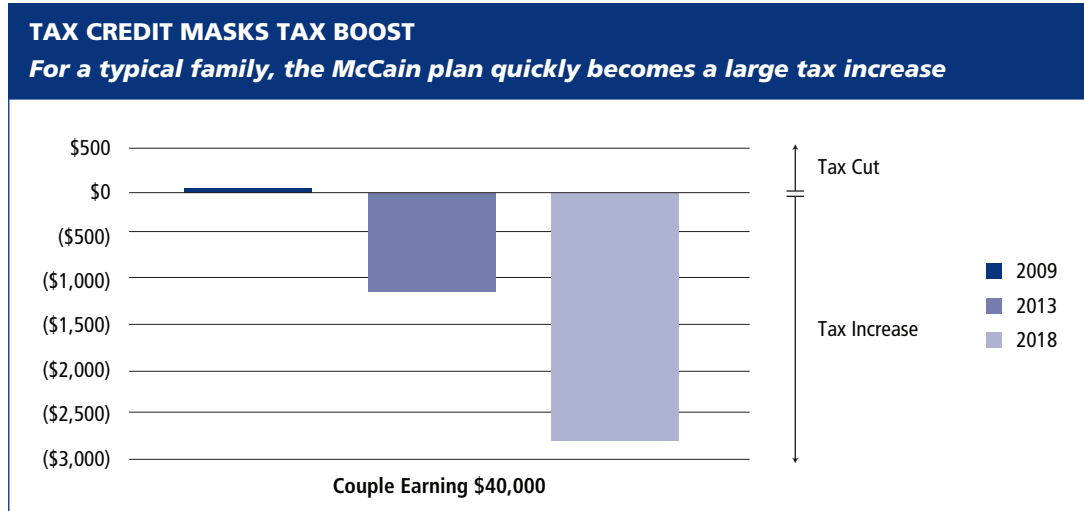
Capping tax benefits at the rate of inflation is not an intrinsic feature of converting the current tax exemption into a health care tax credit. The credit could be designed to increase every year by enough to keep up with rising health care costs. But instead, the McCain campaign consciously decided to shift more health care costs onto families over time.

The chart below shows how quickly premiums will outstrip McCain’s credit. In 2009, the credit will cover 36 percent of an average employer-provided family policy (based upon CBO projections). By 2018, however, the credit will cover only 24 percent of the cost of the same policy.



Source: Congressional Budget Office; Center for American Progress Action Fund.

The next chart shows the impact of the McCain credit on a particular family—a couple earning \$40,000 and paying \$13,800 for insurance, the average premium in 2009 according to CBO projections.<sup>21</sup> McCain’s new tax credit would cut their taxes by \$50 in 2009, but because the credit quickly falls behind rising premiums that are the basis of the current tax break, the family would pay \$1,169 more in taxes in 2013. The family would pay \$2,809 more in taxes by 2018.<sup>22</sup> (More information on how typical families fare under McCain’s proposal, as well as a description of our methodology, is available in the Appendix.)



Source: Center for American Progress Action Fund.

The McCain campaign claims its plan will reduce health costs, but that argument is irrelevant to the calculation of the tax changes faced by particular families. The value of the current tax benefits are determined by premium growth under current law, not McCain’s proposal.

Moreover, the McCain plan is unlikely to make to a meaningful difference in containing costs.<sup>23</sup> Families often cannot seek the best care at the lowest price because there is little public information available on quality of care or costs of procedures.<sup>24</sup>

Some analysts believe that linking subsidies to the amount of premiums encourages plans with minimal copayments and deductibles, which in turn encourages wasteful health care spending.<sup>25</sup> Couched in rhetoric about “freedom” and “responsibility,” McCain says he wants to create a system where families face greater cost-sharing and purchase insurance on their own in the individual market.

In some cases—such as the choice between name-brand and generic drugs—low cost-sharing can lead to wasteful expenditures. Research shows, however, that higher cost-sharing can reduce utilization of needed care and unneeded care at equal rates.<sup>26</sup> Ultimately, this could increase health care costs as individuals decide against paying for care management for chronic diseases and preventive care.<sup>27</sup> According to the Commonwealth Fund, “there is evidence that encouraging people to join such health plans might act as salt on a wound,

exacerbating some of the very maladies that undermine our health care system's ability to perform at the highest level."<sup>28</sup>

The McCain plan also fails to contain costs because it does not achieve universal coverage. As Brookings Institute economist Henry Aaron writes, "covering nearly all Americans is a precondition for effective measures to limit overall health care spending."<sup>29</sup> McCain proposes cost-containment steps, such as fighting chronic disease and promoting the use of information technology, that have earned bipartisan support. But these reforms will not reach millions of Americans under the McCain plan who are chronically uninsured or cycling off-and-on insurance.

The McCain plan may also affect other important aspects of families' well-being, including their eligibility for the Earned Income Tax Credit, and eligibility for future Social Security benefits. For example, because Social Security benefits are based on taxable wages, the McCain plan would presumably increase eligibility for future Social Security benefits. But the McCain plan uses all of the increased Social Security tax revenue to finance his health insurance tax credits. Unless the McCain proposal changes the calculation of future benefits, it would worsen Social Security's long run financial condition by increasing benefits without increasing trust fund revenue. Each of these issues is worthy of further analysis, but are beyond the scope of this paper.

### ***The Largest Tax Increase Falls on Middle-Class Households***

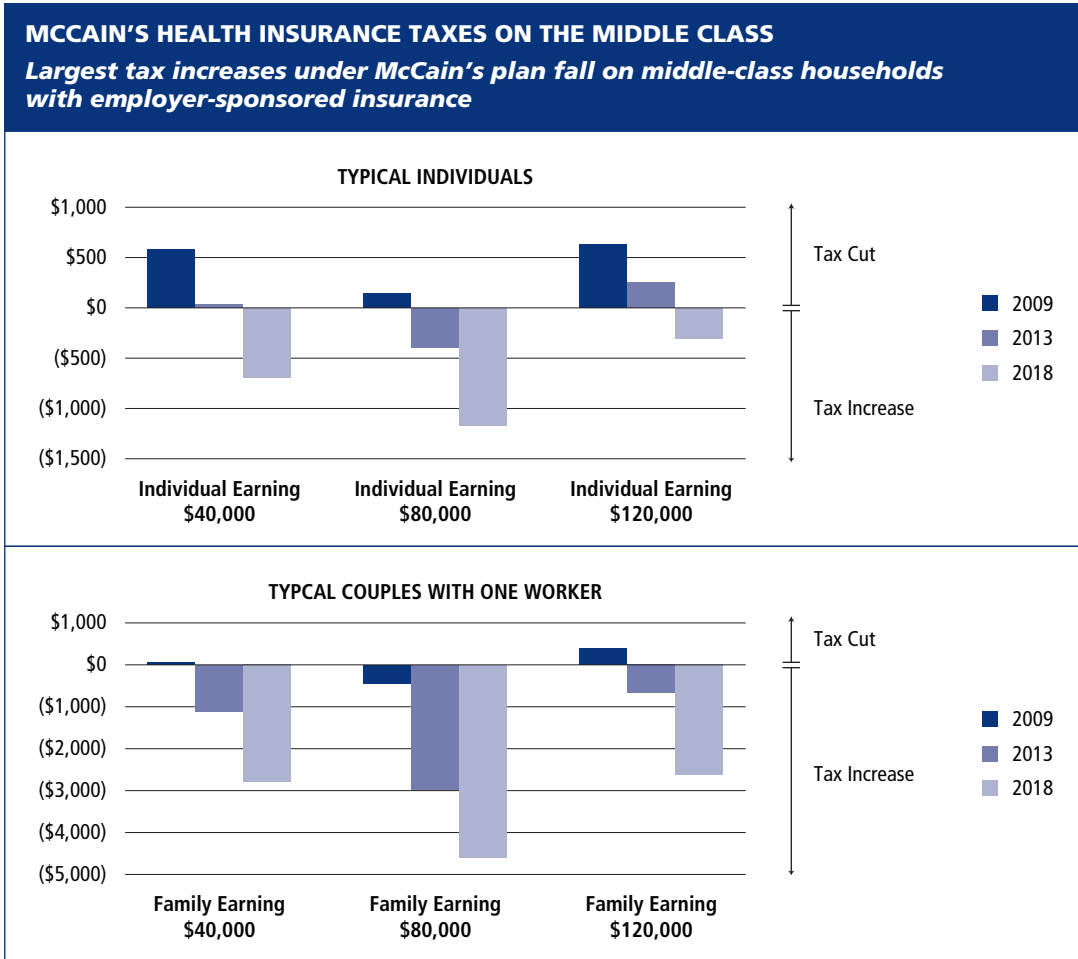
For a particular taxpayer, the most important determinant of whether they will see higher or lower taxes is the marginal tax rate they pay on their income. The largest tax increase falls on people paying the highest marginal tax rate: middle-class families who pay Social Security taxes on all of their wages.

Social Security taxes are projected to apply to the first \$104,000 of an individual's wages in 2009. The Social Security ceiling applies to each worker's wages, so a working couple could pay Social Security taxes on as much as \$208,000 a year. The largest tax increases fall on those who earn enough to be in the 25 percent or 28 percent income tax bracket but not so much that they no longer pay Social Security taxes. Higher income families—those who pay higher income tax rates but no Social Security taxes on their incomes above \$208,000 a year—would see a smaller tax increase. (See table below.)

<b>HITTING THE MIDDLE CLASS</b>	
<b><i>Middle-class households face the largest tax increases</i></b>	
<b>TYPE OF FAMILY</b>	<b>INCOME LEVELS FARING THE WORST UNDER MCCAIN'S PLAN (FOR TYPICAL HOUSEHOLDS IN 2009)</b>
Single*	\$47,500 to \$104,000
Couples with One Worker	\$99,000 to \$104,000
Couples with Two Workers	\$166,000 to \$208,000

\*In 2009, all single households we examined are expected to receive tax cuts. The listed households will get the smallest tax cuts, however, and they will see the largest tax increases in future years.

Source: Center for American Progress Action Fund.



Source: Center for American Progress Action Fund.

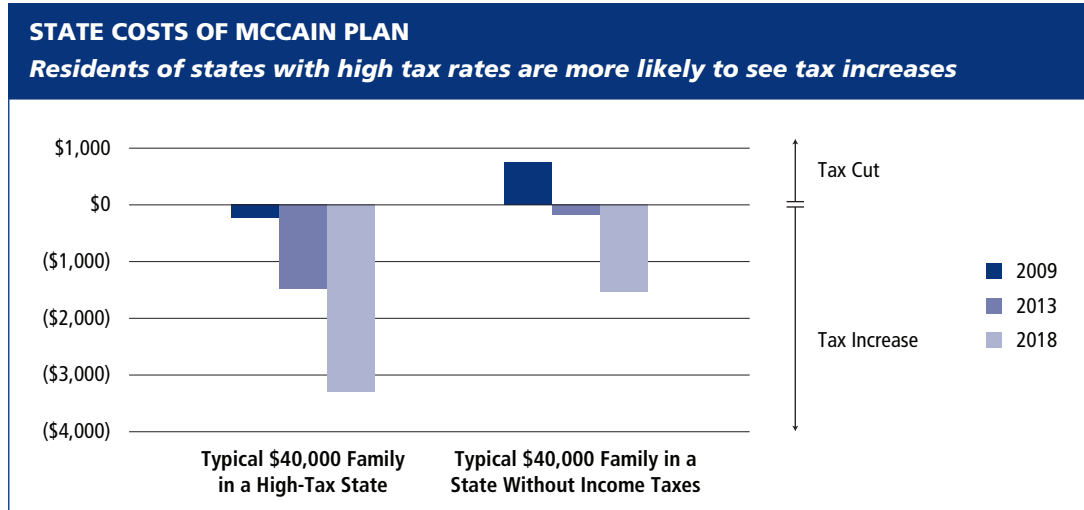
The effect of the McCain plan on typical individuals and couples earning \$40,000, \$80,000, and \$120,000 is presented in the chart above. (Again, more data on these and other households are available in the Appendix.) Once again, the largest tax increases (or smallest tax cuts) go to middle-income individuals and couples. Individuals fare better than couples with similar incomes.

The chart above also illustrates the rapid erosion in McCain's tax credit for health insurance. Initially, five of these six households receive tax cuts. After 10 years, however, all six families are paying higher taxes.

***The McCain Plan Hurts Residents of States with Higher Tax Rates***

States generally adopt the federal definition of income for their own income taxes.<sup>30</sup> Therefore, by subjecting health care premiums to federal taxation, the McCain proposal would also increase many households' state income taxes.

Not everyone pays state income taxes. Nine states (Alaska, Florida, Nevada, New Hampshire, South Dakota, Tennessee, Texas, Washington, and Wyoming) have no state income tax on wages.<sup>31</sup> But other states raise a significant amount of revenue from income taxes. The states



Notes: "High-tax" rate set to 7 percent, the tax rate on \$40,000 families in Arkansas, the District of Columbia, Idaho, Minnesota, South Carolina, and Utah.<sup>32</sup> Higher tax rates for \$40,000 families include 8 percent in Iowa and 9 percent in Oregon.  
 Source: Center for American Progress Action Fund.

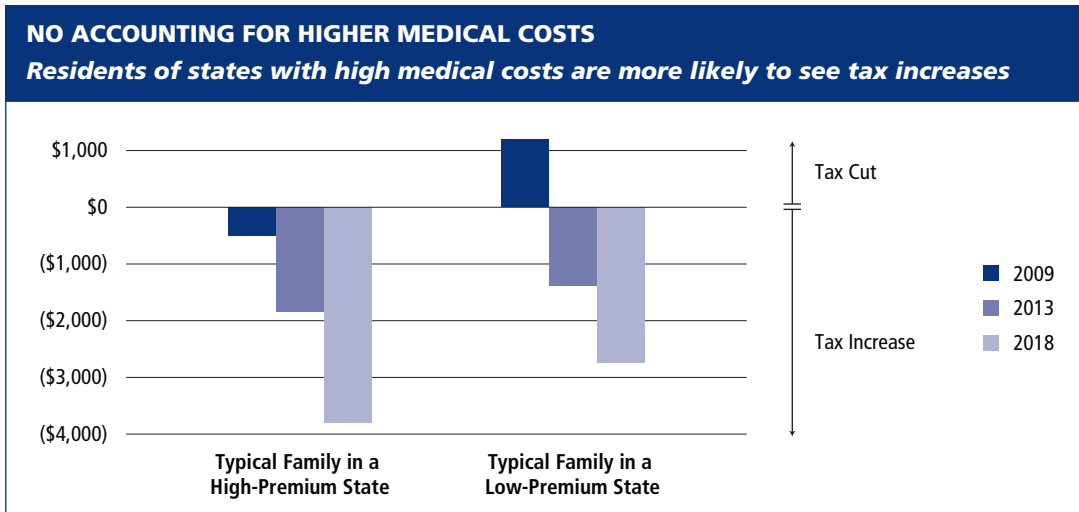
with the highest rates include Vermont, with a top rate of 9.5 percent, California (9.3 percent), and Georgia, Iowa, and New Jersey, all of which have top rates of 9 percent.<sup>33</sup> Subjecting health benefits to taxation will cost residents of these states as much as \$1,300 in 2009.

The chart below examines two families with \$40,000 in income and an average family policy. One family lives in a state with no income taxes, while the other lives in a state with a relatively high income tax rate of 7 percent.

***The McCain Plan Hurts Residents of States with Higher Medical Costs***

Households that pay higher health insurance premiums also fare poorly under the McCain plan. They receive subsidies proportionate to premiums under current law. The McCain proposal takes the opposite approach, providing the same \$5,000 to families no matter how much they pay in premiums.

Physician practice patterns, state laws, the cost of living, and other factors all affect states' average health insurance premiums. In 2005, average family premiums ranged from \$8,334 in North Dakota to \$11,924 in Rhode Island—a variation of more than 40 percent.<sup>34</sup> The McCain plan is more likely to raise taxes on families in these high-cost states, as the chart below demonstrates. The chart examines two families with incomes of \$40,000, one with an average family policy in an expensive state and the other in a state with low premiums.



## McCain Fails to Make Health Insurance Affordable

Sen. McCain's health tax credit is worth \$5,000 for a family, far less than the cost of typical family policies. The cost of an employer policy for a family is projected to average nearly \$14,000 in 2009.<sup>35</sup> As a result, health insurance will remain out of reach for many households, particularly low-income households. Health insurance will also remain out of reach for people with pre-existing conditions.

### Low-Income Households

The affordability of health insurance remains a major issue, especially for low-income individuals and families. Today, one in three individuals who are poor or near poor (with incomes below twice the poverty line) are uninsured, compared to only one in 10 for higher-income individuals.<sup>36</sup>

Policymakers have long recognized that low-income families need more help than those at upper incomes. For example, the State Children's Health Insurance Program covers families with children and modest incomes, and limits premiums and other cost-sharing to 5 percent of income.<sup>37</sup> But the McCain plan offers every individual and family the same tax break, no matter what their income. For many low-income families, a \$5,000 tax credit is too small for them to afford an insurance policy that costs \$13,800.

As a result, many low-income households are likely to decline the tax credit because they cannot afford the remaining health premiums. In this sense, the McCain tax credit would not provide any help at all to many low-income households.

Under the McCain plan, a family near the poverty level could still pay a quarter or more of their income for health insurance after using the tax break. This approaches existing health care costs (including premiums and out-of-pocket expenses) that low-income households already pay in the nongroup market, which are 29 percent of income for individuals and 35 percent for families.<sup>38</sup> In fact, individual market plans might not provide any cap at all on the family cost.<sup>39</sup>

Substantial subsidies are needed to encourage low-income households to purchase insurance.<sup>40</sup> Even 13 percent of low-income families offered employer-sponsored insurance declined the coverage, apparently due to its cost.<sup>41</sup> Similarly, experience in Medicaid has found that premiums are a barrier to enrollment and copayments discourage needed care.<sup>42</sup> When Oregon raised Medicaid premiums, almost half of its beneficiaries dropped out of the program and many become uninsured.<sup>43</sup>

### ***High-Risk Households***

Families covered through work generally pay either a single or family rate. Premiums do not vary by age, the presence of existing illnesses, or family size. The McCain plan, however, would force millions of households into the nongroup market, where households with higher medical needs, such as those who are older or have preexisting illnesses or large families, will find that McCain's tax credit falls far short of their needs.

The McCain plan expands the nongroup market primarily by equalizing the tax treatment of the nongroup and employer-based systems. The elimination of tax incentives for employer-based plans will lead many employers to cancel their health benefits. Employers continuing their plans will see young and healthy workers who could receive the same coverage for less in the nongroup market opt out of employer plans, driving up premiums for the workers left behind. These employers, facing higher costs, may in turn decide to cancel their own plans. The result could be to force millions of people into the nongroup market.

Nongroup plans are less expensive than employer-based plans, on average, but not because they are more efficient. Insurers screen out individuals who are likely to incur substantial medical costs. Moreover, the plans are less generous: Individual plans typically have higher copayments, higher deductibles, and more exclusions for treatments such as maternity care, prescription drugs, mental health, and preexisting conditions.<sup>44</sup> A Consumer Reports study found that median out-of-pocket expenses for those in an individual plan were more than double of those in employer-based plans (\$2,264 vs. \$937).<sup>45</sup> And nongroup plans carry higher administrative costs, which consume 29 percent of their premiums but only 12 percent of premiums in employer-based plans.

In the nongroup market, insurers discriminate among individuals, charging premiums that reflect their real or potential medical costs. People facing higher premiums in the individual market include those with preexisting illnesses, those who are older, or those who have children. In some cases, insurers charge higher rates to all women.<sup>46</sup>

Individuals with expensive conditions, such as cancer or diabetes, can find complete coverage expensive or even impossible to get at any price. A recent study by the Commonwealth Fund found that “nine of 10 people who explored obtaining coverage through the individual market never bought a plan, citing difficulties finding affordable coverage or being turned down.”<sup>47</sup> Individuals suffering from major illnesses often must pay health care premiums on the individual market that are two to four times the average.<sup>48</sup> Older, unhealthy households can pay up to 17 times more in premiums than young, healthy households.<sup>49</sup>

Insurers consider a surprisingly large number of people risky. Four large California insurers exclude entire categories of workers, including roofers, pro athletes, dockworkers, migrant workers, and firefighters—even if they are in good health and can afford coverage.<sup>50</sup> They also reject applicants for past use of eight of the 20 most used prescription drugs in the United States, including top-selling Lipitor.<sup>51</sup>

Older households face similar problems. As the table below shows, households headed by someone in their late 50s or early 60s pay premiums that are about three times larger than the premiums paid by households in their early 20s.<sup>52</sup> As a result, the McCain credit allows young and healthy people to buy more valuable health insurance but forces people who need insurance the most to buy more limited plans if they can access them at all.

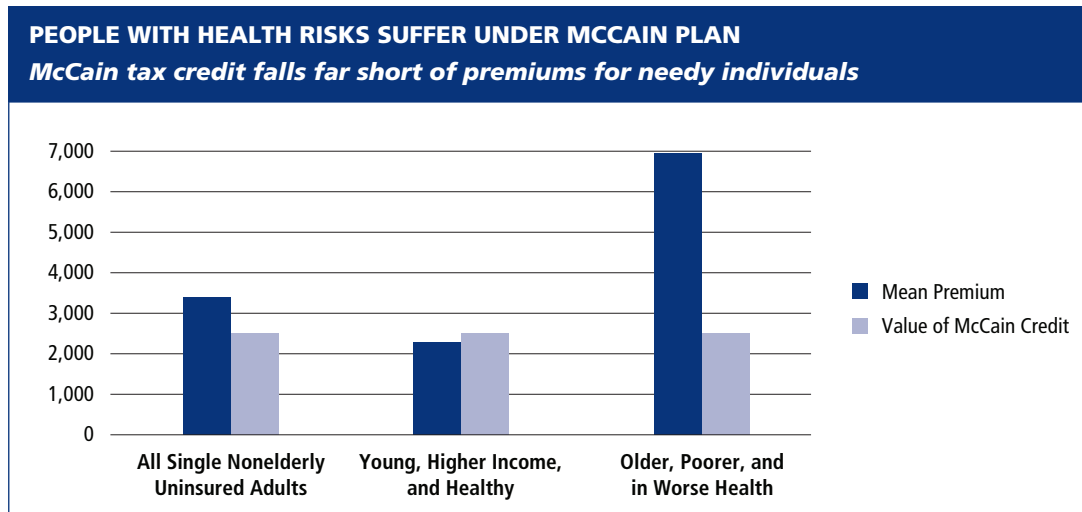
<b>AGE MATTERS UNDER MCCAIN PLAN</b>		
<i>Older households must pay much higher premiums</i>		
	<b>INDIVIDUAL PREMIUMS (COMPARED TO PREMIUMS CHARGED YOUNG ADULTS)</b>	<b>FAMILY PREMIUMS (COMPARED TO PREMIUMS CHARGED YOUNG ADULTS)</b>
18–24	100.0 percent	100.0 percent
25–29	112.9 percent	124.2 percent
30–34	138.1 percent	151.2 percent
35–39	160.8 percent	171.5 percent
40–44	190.8 percent	188.9 percent
45–49	224.5 percent	206.2 percent
50–54	267.0 percent	236.9 percent
55–59	317.7 percent	276.5 percent
60–64	374.5 percent	322.8 percent

Source: America's Health Insurance Plans; Center for American Progress Action Fund.

These figures may understate the affordability problem facing older and sicker households under McCain's plan because the plan undermines state regulation. McCain's plan undermines state protections to limit premium differentials among households or require coverage of certain treatments by allowing insurers to choose which state regulates them. The result: Insurers will shop for the state with the fewest protections for families.

The McCain plan fails to recognize all of these realities, creating only two categories of tax credits—single individuals and families—even though many households face higher premiums because they are older or sicker. The credit amount is likely to be adequate for young, healthy, and high-income individuals, but it falls short of the cost of an average premium for

an individual plan on the nongroup market. Individuals who need health insurance the most will find that the McCain credit covers only about a third of their premiums, as the table below demonstrates.



Source: Congressional Budget Office, "Taxes and Health Insurance: Presentation to the Tax Policy Center and the American Tax Policy Institute," February 29, 2008; Center for American Progress Action Fund.

Finally, families of three or more generally pay higher premiums than couples, yet the McCain tax credit provides the same \$5,000 to all families. It also creates a potential marriage penalty: Two single parents would receive \$5,000 in family tax credits apiece for a total of \$10,000, but if they married they would receive only one credit worth \$5,000—suffering a \$5,000 marriage penalty. It also creates a child penalty: If a childless couple decided to have children, no additional tax credit is given to help cover those children.

## Conclusion

In reducing insurance subsidies for high-income households with the most expensive insurance plans, and then using those savings to offer more help to other households, the McCain plan proposes a step that could be an important part of health care reform. A far better approach, however, would target larger tax increases on high-income households alongside effective cost containment policies. Such an approach would eliminate the need for large tax increases on members of the middle class, and allow greater subsidies for lower income families and the uninsured who need more help affording insurance.

The McCain plan would result in a dramatic reduction of federal tax subsidies for health insurance over time. In 2009, it would make little difference for a typical family earning \$40,000 with an average employer-sponsored plan. But by 2013, the family would be paying more than \$1,000 in taxes.

Some middle-class families would see tax increases immediately, and these tax increases would be larger than the tax increases faced by the highest-income couples in America. Case in point: The largest tax increases on single workers would fall on those making between \$50,000–\$100,000.

Finally, the McCain plan fails to recognize that some households must pay dramatically higher premiums because of their age, health, family size, or even where they live. Instead, he would give the same credits—either \$2,500 for individuals or \$5,000 for families—to everyone. That's a simple solution, but also simplistic and insufficient for the vast majority of Americans.

## Appendix

THE MCCAIN PROPOSAL AND SELECTED FAMILIES, 2009, 2013, AND 2018									
INCOME	INDIVIDUALS			MARRIED COUPLES WITH A SINGLE WORKER			MARRIED COUPLES WITH TWO WORKERS		
	2009 TAX CHANGE	2013 TAX CHANGE	2018 TAX CHANGE	2009 TAX CHANGE	2013 TAX CHANGE	2018 TAX CHANGE	2009 TAX CHANGE	2013 TAX CHANGE	2018 TAX CHANGE
\$10,000	\$1,145	\$866	\$447	\$1,297	\$558	(\$730)	\$1,297	\$558	(\$730)
\$20,000	\$669	\$292	(\$252)	\$469	(\$66)	(\$1,631)	\$469	(\$66)	(\$1,631)
\$30,000	\$669	\$292	(\$252)	\$50	(\$816)	(\$2,454)	\$50	(\$816)	(\$2,454)
\$40,000	\$586	\$32	(\$694)	\$50	(\$1,119)	(\$2,809)	\$50	(\$1,119)	(\$2,809)
\$50,000	\$150	(\$394)	(\$1,181)	\$50	(\$1,119)	(\$2,809)	\$50	(\$1,119)	(\$2,809)
\$60,000	\$150	(\$394)	(\$1,181)	\$50	(\$1,119)	(\$2,809)	\$50	(\$1,119)	(\$2,809)
\$70,000	\$150	(\$394)	(\$1,181)	\$50	(\$2,609)	(\$3,394)	\$50	(\$1,119)	(\$3,394)
\$80,000	\$150	(\$394)	(\$1,181)	(\$452)	(\$2,975)	(\$4,602)	(\$452)	(\$1,980)	(\$4,602)
\$90,000	\$150	(\$394)	(\$1,181)	(\$1,272)	(\$2,975)	(\$5,321)	(\$1,272)	(\$2,870)	(\$5,321)
\$100,000	\$150	(\$567)	(\$1,419)	(\$1,352)	(\$2,975)	(\$5,321)	(\$1,352)	(\$2,975)	(\$5,321)
\$110,000	\$637	\$251	(\$308)	(\$608)	(\$1,934)	(\$4,133)	(\$1,352)	(\$2,975)	(\$5,321)
\$120,000	\$637	\$251	(\$308)	\$387	(\$674)	(\$2,635)	(\$1,352)	(\$2,975)	(\$5,321)
\$130,000	\$637	\$251	(\$308)	\$387	(\$674)	(\$2,206)	(\$1,352)	(\$2,975)	(\$5,321)
\$140,000	\$637	\$251	(\$308)	\$387	(\$784)	(\$2,206)	(\$1,352)	(\$2,975)	(\$5,321)
\$150,000	\$637	\$251	(\$308)	\$387	(\$1,051)	(\$2,242)	(\$1,352)	(\$2,975)	(\$5,357)
\$160,000	\$637	\$251	(\$308)	\$302	(\$1,231)	(\$2,540)	(\$1,437)	(\$3,164)	(\$5,655)
\$170,000	\$637	\$251	(\$308)	\$56	(\$1,231)	(\$2,837)	(\$1,683)	(\$3,431)	(\$5,952)
\$180,000	\$637	\$251	(\$308)	(\$34)	(\$1,231)	(\$2,960)	(\$1,773)	(\$3,532)	(\$6,075)
\$190,000	\$637	\$251	(\$308)	(\$34)	(\$1,231)	(\$2,960)	(\$1,773)	(\$3,532)	(\$6,075)
\$200,000	\$637	\$164	(\$480)	(\$34)	(\$1,231)	(\$2,960)	(\$1,773)	(\$3,532)	(\$6,075)
\$210,000	\$378	(\$92)	(\$772)	(\$34)	(\$1,231)	(\$2,960)	(\$1,525)	(\$2,794)	(\$5,196)
\$220,000	\$378	(\$92)	(\$772)	(\$34)	(\$1,231)	(\$2,960)	(\$285)	(\$1,449)	(\$3,698)
\$230,000	\$378	(\$92)	(\$772)	(\$34)	(\$1,605)	(\$2,960)	(\$34)	(\$1,231)	(\$2,960)
\$240,000	\$378	(\$92)	(\$772)	(\$34)	(\$2,049)	(\$3,232)	(\$34)	(\$1,290)	(\$3,232)
\$250,000	\$378	(\$92)	(\$772)	(\$346)	(\$2,159)	(\$3,727)	(\$346)	(\$1,735)	(\$3,727)
\$260,000	\$378	(\$92)	(\$772)	(\$735)	(\$2,159)	(\$4,216)	(\$735)	(\$2,159)	(\$4,216)
\$270,000	\$378	(\$92)	(\$772)	(\$735)	(\$2,159)	(\$4,216)	(\$735)	(\$2,159)	(\$4,216)
\$280,000	\$378	(\$92)	(\$772)	(\$735)	(\$2,159)	(\$4,216)	(\$735)	(\$2,159)	(\$4,216)
\$290,000	\$378	(\$92)	(\$772)	(\$735)	(\$2,159)	(\$4,216)	(\$735)	(\$2,159)	(\$4,216)
\$300,000	\$378	(\$92)	(\$772)	(\$735)	(\$2,159)	(\$4,216)	(\$735)	(\$2,159)	(\$4,216)
\$310,000	\$378	(\$92)	(\$772)	(\$735)	(\$2,159)	(\$4,216)	(\$735)	(\$2,159)	(\$4,216)
\$320,000	\$378	(\$92)	(\$772)	(\$735)	(\$2,159)	(\$4,216)	(\$735)	(\$2,159)	(\$4,216)
\$330,000	\$378	(\$92)	(\$772)	(\$735)	(\$2,159)	(\$4,216)	(\$735)	(\$2,159)	(\$4,216)
\$340,000	\$378	(\$92)	(\$772)	(\$735)	(\$2,159)	(\$4,216)	(\$735)	(\$2,159)	(\$4,216)
\$350,000	\$378	(\$92)	(\$772)	(\$735)	(\$2,159)	(\$4,216)	(\$735)	(\$2,159)	(\$4,216)
\$360,000	\$378	(\$92)	(\$772)	(\$735)	(\$2,159)	(\$4,216)	(\$735)	(\$2,159)	(\$4,216)
\$370,000	\$378	(\$92)	(\$772)	(\$735)	(\$2,159)	(\$4,216)	(\$735)	(\$2,159)	(\$4,216)
\$380,000	\$378	(\$92)	(\$772)	(\$735)	(\$2,159)	(\$4,216)	(\$735)	(\$2,159)	(\$4,216)
\$390,000	\$378	(\$92)	(\$772)	(\$735)	(\$2,159)	(\$4,216)	(\$735)	(\$2,159)	(\$4,216)
\$400,000	\$378	(\$92)	(\$772)	(\$735)	(\$2,159)	(\$4,216)	(\$735)	(\$2,159)	(\$4,216)

Note: Negative figures represent tax increases.  
 Source: Center for American Progress Action Fund.

## Methodology and Assumptions

Public information available from the McCain campaign lacks clarity on several important details forcing us to make several assumptions before conducting our analysis. First, we assume that the McCain campaign would repeal the exemption for payroll taxes as well as for income taxes. While campaign aides have not stated Sen. McCain's policy definitively, it has estimated that subjecting health benefits to taxation would raise \$3.6 trillion over 10 years, a figure apparently based on a congressional estimate that includes higher payroll taxes.<sup>53</sup> A campaign advisor has also estimated its impact on a typical family by using a 35 percent tax rate; tax rates faced by typical families are close to 35 percent only if payroll taxes are included.<sup>54</sup> As with the Bush plan—which served as the model for the McCain plan—the revenue from additional payroll tax revenue is needed to ensure that the proposal has no net cost to the federal government over 10 years, a stated goal.

Second, we assume that the proposal would prevent employees from shielding health benefits from taxation through cafeteria plans, which allow workers to choose between additional salary and tax-free benefits like insurance. Without such a step, employees would be able to continue receiving tax-free health benefits while receiving McCain's new tax credit, making the proposal enormously expensive and inconsistent with the campaign cost estimate. The Bush proposal that serves as a model for McCain's plan also eliminated this tax preference.<sup>55</sup>

Finally, we assume that the proposal is not optional: Workers would not be allowed to choose between McCain's tax credit and the current tax treatment. Because every taxpayer would choose to minimize their taxes—taking either the current exclusion or the new tax credit, whichever was better for them—allowing such a choice would also have a large cost, defeating the McCain campaign's stated objective of a revenue-neutral reform.

The households described in this report are typical, but the actual impact on real taxpayers will vary. All income is assumed to be salary or wages. Households have no dependents. Workers are assumed to bear the burden of all payroll taxes, even though employers are nominally responsible for half of these taxes.<sup>56</sup> Unless stated otherwise, state income taxes are assumed to be 5 percent above an additional \$5,000 exemption.

Individuals and families are assumed to receive the tax exemption for the average premium on an employer-based plan. Premiums for family policies are projected by the Congressional Budget Office.<sup>57</sup> Premiums for individual policies are based upon the 2007 figures reported by the Kaiser Family Foundation and are assumed to grow at the same rate as family policies.<sup>58</sup>

All premiums on employer-provided plans are assumed to be tax-exempt under current law. Premiums paid by employees are tax-free if paid through a cafeteria plan under Section 125 of the Internal Revenue Code. According to the Joint Committee on Taxation, in 2004 active employees paid \$120 billion on a tax-preferred basis while active employees, COBRA enrollees, and retirees paid \$57 billion in premiums and contributions to health flexible spending arrangements on an after-tax basis.<sup>59</sup>

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