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Obama Is Pressed to Tax Health Benefits

Seeking GOP Votes, Democrats Split Over Plan for New Levy

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The White House is caught in a battle within its own party over how to finance a comprehensive overhaul of America's health-care system, as key Democrats advocate a tax plan that could require President Obama to break his campaign pledge not to raise taxes on the middle class.

Sensitive to voter anxiety about a soaring federal deficit, Obama and congressional leaders have vowed to pay for a sweeping expansion of the health-care system -- expected to cost more than $1 trillion over the next decade -- without additional borrowing.

Much of the money is likely to come from reining in spending on federal health programs for the elderly and the poor. Obama has proposed trimming more than $600 billion from Medicare and Medicaid by 2019 -- including more than $300 billion in cuts unveiled in his Saturday radio and Internet address -- which could fulfill the promise to curb the growth of federal health spending.

The rest of the cash will probably come from new taxes. But Democrats are deeply divided over which taxes to raise, and the issue has become a central stumbling block in the push to enact legislation by fall.

In recent days, Obama has revived a tax plan he first offered in February: limiting itemized deductions for the nation's 3 million highest earners. Polls show that the idea is popular -- it was Obama's biggest applause line last week at an event in Wisconsin -- and it would enable him to abide by a campaign pledge to pay for coverage for the uninsured with new taxes on the rich.

"He believes this is the most equitable way to do this," said senior White House strategist David Axelrod. "It places the burden on people who can most afford it."

But many Democrats, particularly in the Senate, have balked at the idea, saying they prefer a tax that has some hope of winning Republican support. In legislation that could be unveiled as early as this week, Senate Finance Committee Chairman Max Baucus (D-Mont.) is expected to propose a new tax on the health benefits that millions of Americans currently receive tax-free through employers.

Economists say taxing employer-sponsored benefits would help trim runaway health costs and force society to broadly share the burdens of reform. The idea also has bipartisan appeal. Former president George W. Bush and Sen. John McCain (Ariz.), the 2008 GOP presidential candidate, championed a form of the tax; so did Obama advisers Jason Furman and Ezekiel Emanuel before they joined the administration.

"The Democrats are trying to figure out whether they can do health-care reform by themselves without Republicans, or whether they need to adopt some Republican ideas to get a health-care plan," said Chris Edwards, director of tax policy at the libertarian Cato Institute. Taxing health benefits "could be the center of a bipartisan agreement," he said.

But political analysts say the idea is treacherous, especially for Obama. Baucus is considering a tax on employer-sponsored premiums in excess of $15,000 a year, Senate aides said, a plan that would strike many of the very families Obama has vowed to protect from a tax increase. Yesterday, top administration officials pushed back forcefully against the tax, which Obama criticized during the campaign.

"The president starts with the premise that 180 million Americans have health coverage through their employer, that attacks on those benefits may dismantle that marketplace," Health and Human Services Secretary Kathleen Sebelius said on CNN.

Two-thirds of Americans under age 65 get coverage through an employer -- more than 158 million people, according to the Kaiser Family Foundation. In 2008, only about one in five employer-sponsored plans carried the high premiums likely to be hit by the tax.

But research shows that those people tend not to be wealthy highfliers with gold-plated insurance plans, as advocates assert, but those who have to pay high premiums just for basic coverage -- the old, the sick, women of childbearing age and residents of high-cost urban areas. Elise Gould, director of health policy research at the liberal Economic Policy Institute, found that a similar cap suggested by a 2005 tax reform panel would have raised taxes mainly on workers with family coverage, many of them in smaller firms with high concentrations of older, female or unionized workers.

Labor leaders, who have for years chosen better health benefits over higher wages in contract negotiations, call the tax a deal-killer. "It has the capacity to really undermine trust in a basic kind of way," said Gerald Shea, assistant to the president of the AFL-CIO. "If you say you really, really want to help out the middle class, what are you doing charging more for the health care that's already costing us an arm and a leg?"

It could also prove poisonous in the 2010 elections. In a recent survey for Health Care for America Now, a labor-backed reform advocacy group, Democratic pollster Celinda Lake found that 80 percent opposed a tax on benefits, compared with 63 percent support for limiting itemized deductions for high earners.

"Taxing benefits would be a disaster," Lake said. "You have no idea how strongly this is going to backfire if we do it."

Key lawmakers in the House don't particularly like either of the competing tax plans and may yet offer a third proposal. But in the Senate, the more important congressional battleground, taxing health premiums "has reached the level of a foregone conclusion," said Len Nichols, a health policy analyst at the nonpartisan New America Foundation.

Politics aside, the tax dwarfs all other current proposals as a potential cash cow. The tax-free treatment of employer-provided health insurance is the biggest loophole in the tax code and the second-largest federal health-care cost, after Medicare. Taxing half of all employer-sponsored premiums would generate nearly $1.2 trillion over the next decade, according to the nonpartisan Joint Committee on Taxation, compared with about $270 billion for new limits on itemized deductions for the rich.

Advocates say taxing benefits also makes good economic sense. The rewards of the current tax break fall heavily to the wealthy, and there is no similar tax break for workers who must buy insurance on their own. Many economists also dislike it because it encourages workers to take compensation in the form of health care instead of higher wages, pushing resources into the health system and increasing costs.

"Even in the absence of wanting the money, you'd want to do it," said MIT economist Jonathan Gruber.

Senate Democrats have been considering two options. The first would be to tax premiums above a certain level, such as the value of the standard family plan offered to federal employees, which will be about $15,000 in 2013, Senate aides said. That would raise about $420 billion over 10 years. The other option would be to apply the cap only to families earning more than $200,000 a year ($100,000 for individuals), which would raise about $160 billion over 10 years.

A senior Baucus aide said the committee is leaning toward the former option, which would do more to "bend the curve" of soaring health costs.

In either case, workers would see any insurance premiums in excess of the cap added to their wages and taxed as income. That could increase their tax bills by hundreds or thousands of dollars a year, said Paul Fronstin, director of health research at the nonprofit Employee Benefit Research Institute.

The Baucus aide stressed that the goal of reform is to lower premiums for everyone. But the White House is clearly not convinced.

"There is still a great deal of disagreement," Sebelius said, "on whether or not taxing benefits at any level of any kind really does put us a step forward or take us a step back."

Polling analyst Jennifer Agiesta contributed to this report.