

How Do ACA Tax Credits Affect Premiums and Enrollment?



To encourage enrollment in the new individual insurance exchanges, the Affordable Care Act (ACA) offers tax credits to help lower-income individuals and families buy coverage. These tax credits have faced multiple court challenges. In early November 2014, the U.S. Supreme Court announced that it will hear *King v. Burwell*, a challenge that disputes the legality of the ACA's tax credits in the 34 states with federally run health insurance exchanges. What's at stake if the Supreme Court upholds this challenge?



**85 percent
of 2014
exchange
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How ACA Subsidies Work

Buyers in the individual health insurance market are eligible for tax credits if their incomes fall between 100 and 400 percent of the federal poverty level (about \$24,000 to \$96,000 for a family of four) and they have no offers of coverage from other sources. According to estimates from the U.S. Department of Health and Human Services, 85 percent of enrollees in last year's exchanges received tax credits.

A family of four with an annual of income of \$52,000—median U.S. income, according to recent data reported by the U.S. Census Bureau—is required to contribute about \$3,600 annually toward health insurance premiums, with the federal government paying the rest (up to the cost of a benchmark plan). In many states, the benchmark premium for a family of four could exceed \$10,000, so the annual value of the tax credit for a family can exceed \$6,000.



Family of four with median
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The ACA's tax credits are designed to shield buyers from premium rate shocks. Families' required contributions are based on income, ranging from 2 percent of income for those just above the federal poverty level to 9.5 percent of income for individuals at 400 percent of the federal poverty level. If premiums increase, families do not have to pay additional costs above the required contribution, as long as they enroll in the benchmark plan or a less expensive plan. The federal government bears the additional cost.

Subsidies Boost Enrollment and Keep Premiums Low

What would happen if the government stopped offering subsidies? To answer this question, RAND researchers used the COMPARE microsimulation model, which assesses the effect of policy changes on individual enrollment decisions and premium prices.

Eliminating Subsidies Will Raise Premiums and Lower Enrollment

The analysis found that eliminating tax credits in *all states* would severely disrupt the individual insurance market. Specifically, eliminating tax credits in all states would cause:

- Premiums in the individual market to rise 43 percent
- Enrollment in the individual market to fall by 68 percent; 70% among adults ages 18–34
- More than 11 million Americans to become uninsured

When we restricted the analysis to the 34 states with federally facilitated marketplaces (FFMs), we found that eliminating subsidies in FFM states would cause:

- Premiums in the individual market in FFM states to rise 47 percent
- Enrollment in the individual market in FFM states to fall by 70 percent
- About 8 million Americans to become uninsured

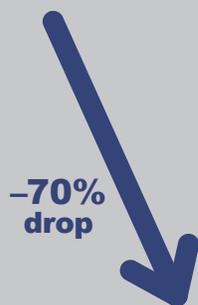


Individual market premiums rise by 47 percent in FFM states if tax credits are eliminated

ACA enrollment falls without some help through tax credits

Federally Facilitated Marketplaces

13.7 M with subsidies



-70% drop

4.1 M without subsidies

47%
Individual market premiums rise
8M
increase in uninsured



All States

19.8 M with subsidies



-68% drop

6.3 M without subsidies

43%
Individual market premiums rise
11M
increase in uninsured



Figures here represent enrollment in the ACA-compliant individual market (not just the FFMs). Age-standardized premiums increase by \$1,613 per individual in FFM states when subsidies are withdrawn, a 47% increase, rising from \$5,063 to \$6,676 annually, and increase by \$1,500 per individual in all states, a 43% increase, rising from \$4,900 to \$6,400 annually. Age-standardized premium reflects the silver premium for a 40-year-old nonsmoker.

Tax credits exert a stabilizing effect on the market



The effects on premiums and enrollment are slightly larger in FFM states than in all states because FFM states had a higher percentage of uninsured individuals prior to the ACA, and a lower-income population. Further, many FFM states have declined to expand Medicaid, which increases low-income individuals' reliance on exchange tax credits.

What explains this effect?

Tax credits influence the behavior of both high- and low-risk populations. High-risk people—those with poorer health and higher health care costs—are likely to sign up for coverage regardless of subsidies. In contrast, low-risk individuals—typically, younger, healthier adults—may need a tax credit to entice them to enroll. When these individuals sign up for coverage, they improve the risk pool and bring premiums down.

By encouraging enrollment among younger, healthier adults, tax credits in the individual market reduce premium costs for everyone, not just people with tax credits. The modeling results show that, without tax credits to attract low-risk enrollees and to cushion lower-income enrollees from the effect of premium increases, large numbers of potential buyers will not enroll, leading to steep premium hikes for those who remain in the market. The resulting exchanges will consist of a small number of high-risk enrollees, leaving the majority of potential buyers priced out of the market.

The Future? Stability or Disruption Depends on Tax Credits

Ultimately, whether tax credits are allowed in the federally run exchanges will be decided on legal grounds. Regardless of how the Supreme Court rules, however, the economics of the situation will not change. The tax credits exert a stabilizing effect, and therefore eliminating them will result in a substantial disruption to the market.

Photographs courtesy of Fotolia.



This brief describes work done in RAND Health documented in *Assessing Alternative Modifications to the Affordable Care Act: Impact on Individual Market Premiums and Insurance Coverage*, by Christine Eibner and Evan Saltzman, RR-708-DHHS, 2014 (available at www.rand.org/t/RR708), and *The Effect of Eliminating the Affordable Care Act's Tax Credits in Federally Facilitated Marketplaces*, by Evan Saltzman and Christine Eibner, RR-980-RC, 2015 (available at www.rand.org/t/RR980). To view this brief online, visit www.rand.org/t/RB9812z1. The RAND Corporation is a research organization that develops solutions to public policy challenges to help make communities throughout the world safer and more secure, healthier and more prosperous. RAND is nonprofit, nonpartisan, and committed to the public interest. RAND's publications do not necessarily reflect the opinions of its research clients and sponsors. **RAND®** is a registered trademark. © RAND 2015

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