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Expanding SCHIP into AMT Territory: SCHIP Plan Would Extend Welfare to Wealthy Families

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According to the federal government, thousands of American families are both poor and high-income—simultaneously. These families are considered poor enough to be eligible for the State Children's Health Insurance Program (SCHIP) program, but under the tax code, they are considered wealthy and so forced to pay the Alternative Minimum Tax (AMT). Their ranks may grow if Congress moves forward with plans to expand SCHIP eligibility to wealthier families. The unlikely convergence of these two programs shows how the best intentions of Congress can go astray and result in conflicting priorities. Instead of making this problem worse by expanding SCHIP, Congress should keep SCHIP focused on low-income families and extend the “hold harmless” provision of the AMT while planning for permanent AMT reform.

Programs for the Poor and the Rich. SCHIP was created in 1997 to provide health insurance for children in low-income families whose income exceeded eligibility for Medicaid. Originally, children in families with income below 200 percent of the federal poverty line (FPL) were eligible for SCHIP. Since that time, many states have expanded the program to include children in families with much higher incomes.

At the opposite end of the spectrum lies the alternative minimum tax. The AMT was created to force extremely wealthy taxpayers to pay income tax by limiting their credits and deductions. The AMT forces these families to exclude several credits and deductions, particularly those for state and local taxes, when calculating their tax liability. As a con-

sequence, the families most at risk of being forced to pay the AMT live in wealthier, high-tax states, such as the New England states, New York, New Jersey, and California.

Welfare for the Wealthy? Now Congress is debating legislation to expand SCHIP to families at up to 400 percent of the FPL. This means a family of four earning \$80,000—hardly low income—would be eligible for SCHIP. In fact, this family would be in the upper half of the income distribution and closer to the top quintile than the middle quintile. An expansion of SCHIP this large would mean the program would no longer be targeted at low-income families but actually include high-income families as well.

If Congress were to extend SCHIP to families at 400 percent of the FPL, approximately 70,000 families would receive a subsidy from SCHIP and pay the AMT.¹ Thousands more will fall into this group if Congress fails to extend the “hold harmless” provision of the AMT.

Families in states with high local or state taxes are more likely to fall under the proposed SCHIP expansion and the AMT. For example, more families would be affected in New York (12,600) than

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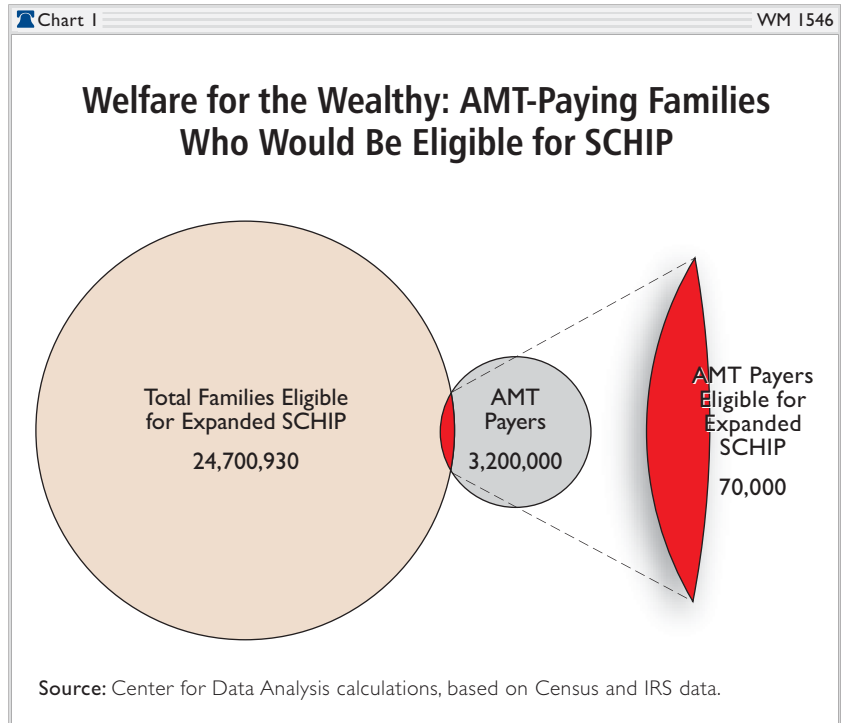
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other states, because more New York families are likely to be subject to the AMT.

Bad for SCHIP. With its proposed SCHIP expansion, Congress would end any pretension that SCHIP is a program for low-income families. Many of the potential new beneficiaries have incomes well above the median income of families in the United States. The state of Maryland, for example, proposed expanding SCHIP to families making just over \$80,000, which is almost 150 percent of U.S. median family household income.

Expanding SCHIP to wealthier families adds to the cost of the program. SCHIP already runs deficits in many states, and these shortfalls will grow in the near future.² If states cannot pay for SCHIP now, it makes little sense to expand the program to cover high-income families. States have already appealed to the federal government for bailouts (and won several such bailouts) because they have spent too much on expanding SCHIP to cover wealthier families.³

While the Department of Health and Human Services treats these families as low-income families needing government assistance, the tax code sees them as wealthy taxpayers who are not paying their fair share of taxes.⁴ When the AMT was created, its purpose was to force 155 wealthy taxpayers to pay more in taxes by limiting their credits



and deductions. Since the AMT is not indexed for inflation and the tax code has added more deductions, millions of additional taxpayers are now subject to the AMT, including families who may soon qualify for SCHIP.

While this confusion may be comic, it has some troubling consequences. SCHIP crowds out the insurance that some of these families currently possess.⁵ SCHIP spending has surpassed expectations and budgets, leading to shortfalls of \$720 million in 2007 alone.⁶ And families have less money to spend when they have to pay the AMT.

1. The number of families eligible for both SCHIP and the AMT was calculated by using SCHIP eligibility criteria for families earning less than 400 percent of the FPL and the percentage of families within that income range subject to the AMT. Calculations are based on Census Bureau, 2006 March Current Population Survey, and Internal Revenue Service, Statistics of Income Division, Individual Master File System, January 2006, at www.irs.gov/pub/irs-soi/04in54cm.xls.
2. Nicola Moore and J.D. Foster, Ph.D., "SCHIP Reauthorization: Congress Should Beware of Creating a New Entitlement," Heritage Foundation *WebMemo* No. 1540, July 9, 2007, at www.heritage.org/Research/HealthCare/wm1540.cfm.
3. Nina Owcharenko, "The Truth About SCHIP Shortfalls," Heritage Foundation *WebMemo* No. 1381, March 25, 2007, at www.heritage.org/Research/HealthCare/wm1381.cfm.
4. Andrew Chamberlain and Patrick Fleenor, "Backgrounder on the Alternative Minimum Tax (AMT)," The Tax Foundation, *Fiscal Facts* No. 26, May 24, 2005, at www.taxfoundation.org/publications/show/498.html.
5. Andrew M. Grossman and Greg D'Angelo, "SCHIP and 'Crowd-Out': How Public Program Expansion Reduces Private Coverage," Heritage Foundation *WebMemo* No. 1518, June 27, 2007, at www.heritage.org/Research/HealthCare/wm1518.cfm.
6. Nina Owcharenko, "The Truth About SCHIP Shortfalls."

Conclusion. If SCHIP is expanded, thousands of families will find themselves eligible for taxpayer-funded government benefits even while they are forced to pay higher taxes through the AMT. It is not surprising that Congress would handle these families inconsistently. Given policymakers' misguided urge to increase federal spending and intervention, lawmakers will continue to look for more ways to raise taxes. Thus Congress treats the same families in two contradictory ways, granting benefits with one hand and taking away taxes with the other. When this happens, taxpayers and families lose. They no longer have a choice in how to spend their money and instead must rely upon the government to make decisions for them.

Congress should not expand SCHIP to families that have income at 400 percent of the FPL. This would be the first step toward turning a program for children from low-income families into an expensive entitlement for families with above-average incomes. Instead, Congress should keep SCHIP focused on low-income families and reduce the onerous burden of the AMT. If Congress wants to help these families, it should lower their taxes so that families can keep more of their money.

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