

medicaid
and the uninsured

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EXPLAINING HEALTH REFORM

The New Rules for Determining Income Under Medicaid in 2014

To provide individuals and families access to affordable, high-quality health care, the Patient Protection and Affordable Care Act (ACA) expands Medicaid to cover low-income adults and children with incomes up to 133 percent of the poverty line. Millions of low-income parents, non-disabled adults who do not have dependent children (and who are generally ineligible for Medicaid today except in a small number of states) and, in some instances, children now covered through the Children's Health Insurance Program (CHIP) will become newly eligible for health coverage through Medicaid as a result.

In addition, individuals and families who have incomes above the level needed to qualify for Medicaid but below 400 percent of the federal poverty line will receive tax credits to help them purchase coverage in the new health insurance exchanges. People with incomes up to 250 percent of the poverty line receiving premium credits will also get additional assistance with their cost-sharing charges. In total, an estimated 33 million more people who would otherwise be uninsured are expected to have coverage through Medicaid, CHIP and the exchanges by 2021.

To ensure coordination of eligibility and coverage across the different health care programs, the ACA requires states to make major changes in the way that they determine eligibility for Medicaid and CHIP in order to align with the income tax-based rules for premium credits in the exchanges. The biggest change involves how income and household size are defined to determine eligibility for Medicaid and CHIP (as well as the exchange premium credits). This issue brief explains the new rules, and describes the differences between these new rules and the current income counting rules used in Medicaid and CHIP.

The New Income and Household Size Definitions

The health reform law establishes a new definition of income — called Modified Adjusted Gross Income, or MAGI — that will be used in determining eligibility for premium credits. MAGI is Adjusted Gross Income as determined under the federal income tax, plus any foreign income or tax-exempt interest that a taxpayer receives.¹ Assets will not be considered in determining eligibility.

Furthermore, in determining income eligibility for premium credits, an individual's family size will be based on the number of personal exemptions that an individual claims in his or her tax return (the tax filing unit). A household's income thus is the MAGI of the taxpayer, the spouse (if any), and any child or other person whom the individual claims as a tax dependent, including the income of any person who must report his or her income on a separate return but is still claimed as a dependent by the taxpayer. A taxpayer's family size thus would be four if the taxpayer claimed himself or herself, a spouse, and two children as exemptions on his or her tax return. In order to be eligible for the premium credit, married couples are required to file a joint tax return.

Starting in 2014, eligibility for most Medicaid and CHIP beneficiaries under age 65 will also be determined using MAGI, and family size will also be based on the tax filing unit. The family's assets will not be considered in determining eligibility. These new income eligibility rules generally will apply to all children except foster children, who automatically qualify for Medicaid, and to all adults under 65 except those who qualify for Medicaid as a disabled individual. The health reform law does *not* change Medicaid eligibility rules for beneficiaries who are 65 or older or those in eligibility categories based on disability.

¹ Under the tax code, foreign income and tax-exempt interest are generally excluded from Adjusted Gross Income.

Key Differences Between MAGI and Medicaid's Current Income Counting Methodologies

In Medicaid today, the rules for counting income vary from state to state and also differ based on the category through which an individual is eligible for the program. For example, Medicaid allows applicants to disregard some child support payments and the first \$90 of earned income, and to deduct certain childcare expenses from income when determining eligibility for benefits. States also have the flexibility to disregard additional income and deduct other expenses, and a number of states have used this authority to expand Medicaid eligibility. States' use of deductions and income disregards has the effect of increasing income eligibility standards for many families, but they also have resulted in a somewhat more complex application and renewal process.

Starting in 2014, with the switch to MAGI, states will no longer be able to maintain their current disregards and deductions in determining whether someone qualifies for benefits. Instead, there will be a single methodology that will determine how income is counted. The use of MAGI will standardize and simplify income eligibility across states and between Medicaid, CHIP and the exchange premium subsidies, and help lower state administrative costs related to eligibility determinations, by adopting what is essentially a gross income test.²

The new rules also are very different from the way Medicaid calculates gross income today. In particular, many items now *included* in income for the purposes of determining Medicaid eligibility are *excluded* from taxable income for purposes of the federal income tax — and hence will not count when using MAGI. Key differences between income tax and Medicaid rules for what counts as income include the following:

Child support that a family receives: Currently, the child support that a family receives (generally after the first \$50 a month, which is excluded) *counts* as income when Medicaid eligibility is determined. However, federal income tax rules *do not count* child support in determining the income of the parent receiving it, because the parent who pays the support has already paid tax on that income.

Social Security benefits: Under the tax code, Social Security benefits are fully excluded from income for filers with low or moderate incomes.³ As a result, Social Security survivors and disability benefits generally will *not* be counted in determining eligibility for Medicaid under the MAGI definition. In contrast, Medicaid currently counts Social Security benefits as income. Consequently, the new rules will broaden Medicaid eligibility for many people under 65 who have a disability but who do not qualify for Medicaid under their state's Medicaid disability category because their incomes or assets, as determined under current Medicaid rules, exceed their state's income and/or asset limit for the Medicaid disability category. Thus, many people with disabilities who have begun to receive Social Security benefits but do not yet receive Medicare (since there is a two-year waiting period for Medicare) will become eligible for Medicaid, because their income exclusive of their Social Security benefits will be below 133 percent of the poverty line.⁴

² In determining eligibility, states will be required to reduce countable income by an amount equal to 5 percent of the poverty line, so the Medicaid income eligibility threshold effectively becomes 138 percent of the federal poverty line.

³ Under the tax code, Social Security benefits are excluded from income unless the sum of 50 percent of a tax filer's Social Security benefits and the filer's other countable income exceeds certain income thresholds (in which case a portion of the Social Security benefits is counted in Adjusted Gross Income). For the majority of Social Security beneficiaries the sum of 50 percent of Social Security benefits and other income is *below* the threshold and, as a result, *none* of their Social Security benefits are counted as income under the tax code.

⁴ See Judith Solomon, "Health Reform Expands Coverage for People with Disabilities," Center on Budget and Policy Priorities, July 29, 2010.

Pre-tax contributions for purposes such as child care costs, retirement savings, certain commuting costs, employee's share of employer-sponsored health insurance premiums paid through a cafeteria plan, and flexible spending accounts: These portions of an employee's earnings are not counted as income under income tax rules and hence will also be excluded in determining MAGI. These amounts currently are counted in determining eligibility for Medicaid.

Alimony paid: Medicaid does not deduct from countable income any alimony paid by an individual. Under federal income tax rules, however, amounts paid towards alimony are deducted from income when computing a taxpayer's Adjusted Gross Income.

Key Differences Between the Medicaid and Income Tax Definitions Related to Family Size

The new rules also change how family size is calculated and how household income is defined. Currently under Medicaid, states take different approaches to determining family size and which family members' income to count depending on who in the family is applying for benefits. In general, Medicaid programs *must* consider the incomes of parents and spouses in determining an individual's eligibility. Income of other family members is counted only if they are also applying for coverage. For example, Medicaid would exclude the income of a grandmother caring for her grandchild in determining eligibility of the child, but if the grandmother was applying for coverage with the grandchild, the grandmother's income would be counted in determining whether she and her grandchild are eligible.

Under the new rules, however, family size and household income will be based on the tax filing unit. All individuals claimed as a dependent on a taxpayer's return will be included in determining that taxpayer's family size. The total income of a household will thus equal the MAGI of all individuals in the tax filing unit, including the MAGI reported on a separate tax return for any of these individuals if they were required to file a separate return. For example, if a teen-age child has an after-school job and earns income that exceeds the minimum tax filing threshold, the teen-ager is required to file his or her own tax return even though the teen-ager's parents still claim him or her as a dependent on their own return. In determining the family's eligibility for Medicaid and premium credits, however, the teen-ager's MAGI will be added to the rest of the family's MAGI. The following examples illustrate how these rules differ from those now used in Medicaid:

Step-Parents. Assume, for example, that a family includes a taxpayer and the taxpayer's spouse — both of whom work — their child, and a child of the taxpayer from a previous marriage. The taxpayer's tax return includes the spouse and both children. Under the health reform law, the family's MAGI will be determined based on the income of both parents. Under current Medicaid rules, however, most states would initially determine the eligibility of the entire family counting both spouses' income, but if the family's income exceeded the Medicaid eligibility limits, the eligibility of the step-child would then be determined considering only her own parent's income (because the step-parent is not legally responsible for the child). If using just her own parent's income puts the step-child below the applicable Medicaid income eligibility limit (for a family of two), the child currently is eligible for Medicaid.⁵

Non-Custodial Parents. With the new tax-based definition of family size, a child claimed as a dependent on a non-custodial parent's tax return will not be counted in determining the family size of the custodial parent's household. The ACA states that in such cases, a premium credit is not allowed with respect to the child.⁶ This

⁵ The parent would not be eligible, because his or her spouse's income also would be considered in determining Medicaid eligibility. It should be noted that separate CHIP programs do not necessarily follow this rule in determining eligibility for CHIP.

⁶ Section 36B(c)(1)(D) of the Internal Revenue Code as added by section 1401 of the Affordable Care Act.

means that such a child will not be able to get coverage as part of the custodial parent's coverage but would be eligible to receive coverage through the non-custodial parent. Since only one parent can claim the child as a dependent, this may result in different choices about which parent claims the child for tax purposes. However, the statutory requirement that a child obtain coverage with the parent claiming that child is specific to the premium credits. It is unclear whether this will apply to Medicaid as well, which should be addressed by federal guidance.

Implications of New Rules for Medicaid and Future Policy Considerations

Under the health reform law, states will need to make major changes to the way they conduct Medicaid eligibility determinations for individuals and families. The use of a new national standard for counting income and family size will help simplify eligibility rules and processes over the long-run and help reduce the administrative cost burden of determining eligibility for Medicaid and CHIP. At the same time, however, using a tax-based definition of income and family size will bring a set of new challenges.

One such challenge involves reconciling the use of income from a prior year's tax return in determining eligibility with Medicaid rules that require eligibility determinations based on current or point-in-time income. This is particularly important since many low-income individuals do not file tax returns and/or have fluctuating incomes that may cause them to move in and out of eligibility over time.

In addition, MAGI is calculated on an annual basis, whereas Medicaid typically looks at income on a monthly basis. Thus, a process may need to be established for "projecting" the average monthly equivalent of income that is reported to individuals annually, such as interest or dividend income earned over the course of a tax year.

As the federal government develops guidance to help states prepare for the transition to MAGI and the new definition of family size, it will be important to resolve these issues so that Medicaid and premium credit eligibility rules are aligned, thereby ensuring that individuals and families applying for benefits are enrolled in the appropriate program. It will be critical to establish a process that is simple and easy to navigate, so that eligible individuals and families are not unnecessarily discouraged from applying for benefits. This will likely involve technical assistance and education for applicants, particularly those with complicated income and family composition circumstances. Future guidance will also need to address how to effectively transition people between coverage through Medicaid, CHIP and premium credits as their income or circumstances change.

Adopting the tax code's definitions of countable income and of what constitutes a family will represent a significant departure from the way that states now determine eligibility for Medicaid. While these changes will not become effective until 2014, states will need guidance on these changes well in advance so they can begin to prepare for the systems and policy changes, as well as staff training, that will be necessary for effective implementation.

This paper was prepared by January Angeles from the Center on Budget and Policy Priorities for the Kaiser Commission on Medicaid and the Uninsured.

Appendix:
Comparison of the Tax Code and Medicaid’s Treatment of Income

	Federal Income Tax	Medicaid
Earned income: General rule	Includes earned income such as wages, salary, tips, commissions and bonuses. Major exclusions from earned income in determining Adjusted Gross Income are listed below.	Includes earned income, in cash or in kind, including wages, salary, commissions, or profit from self-employment or employment-related activities. Medicaid disregards the first \$90 of earned income and, in some cases, \$30 plus one-third of the earned income not already disregarded. States can disregard additional income sources, or deduct additional expenses when counting income for the purposes of determining Medicaid eligibility.
Salary reduction contributions for dependent care, transportation and certain health expenses	Pre-tax contributions to salary reduction plans (of up to \$2,500 or \$5,000 depending on filing status) for payment of dependent care are not counted in Adjusted Gross Income. Other contributions for transportation and certain health expenses are not included in Adjusted Gross Income.	Medicaid deducts some income used for dependent care expenses, but applies different limits than what is allowed under the tax code. States deduct from monthly income child care expenses up to \$175 for each dependent child at least two years old, and up to \$200 for each dependent child under age two. States have the flexibility to deduct greater amounts. To the extent that an individual makes pre-tax contributions for payment of dependent care, the gross income prior to the deduction is counted. Salary reduction contributions for transportation and certain health expenses are included in countable income.
Self-employment income	Included in Adjusted Gross Income, but the tax code allows deductions for various business expenses , such as depreciation, business-related travel and entertainment expenses (up to a limit), and business use of a personal home. If the deductions exceed the income earned from self-employment, the losses can be used to offset other income, up to a limit.	Included in countable income, but items that can be deducted for various business expenses do not line up with what is allowed under the tax code. For example, items such as depreciation, personal business and entertainment expenses, purchase of capital equipment and payments on the principal of loans for capital assets or durable goods are not considered business expenses in most states. In addition business losses are not offset against other income.

Unearned income: General rule	Generally included in Adjusted Gross Income. However, major categories of unearned income that are excluded from Adjusted Gross Income are listed below.	Unearned income, whether received in cash or in kind is generally included in countable income.
Social Security (and equivalent Tier 1 railroad benefits)	Generally not included in Adjusted Gross Income for most low-income people. The portion of Social Security payments that is included in Adjusted Gross Income is determined by a test that takes into account other income.	Generally included in countable income, although certain amounts may be disregarded for seniors and people with disabilities.
Veteran's benefits	Not included in Adjusted Gross Income.	Included in countable income.
Child support received	Not included in determining the Adjusted Gross Income of the person receiving the payments.	Included , but Medicaid disregards at least the first \$50 of child support received per month. States have the flexibility to disregard a higher amount of income received for child support.
Alimony received	Included in Adjusted Gross Income. (Alimony paid is deducted from income in computing Adjusted Gross Income)	Included in countable income. (Alimony paid is not deducted from countable income.)
Worker's compensation	Not included in Adjusted Gross Income if paid under a workers' compensation act or a statute in the nature of a workers' compensation act. The exclusion also applies to compensation received by survivors of someone receiving workers' compensation.	Included in countable income if paid as replacement for wages. Compensation that is earmarked and used for specific purposes, such as money for past medical bills resulting from accident or injury or funeral costs, is not included in countable income.
Gifts and inheritances	Not included in Adjusted Gross Income. Income generated from gifts and inheritances, such as rent received for property, is taxable.	Included in countable income. Medicaid treats large gifts and inheritances as lump sum income unless it is in the form of property, in which case it is treated as an asset. (States vary in their treatment of lump sum income. Some treat it as unearned income in the month it is received and any amount leftover as a countable resource in the months following receipt, while others project it as monthly income over a certain period by dividing the lump sum income and other income by the income eligibility standard for a family, taking into account family size) There is a state option to exclude small nonrecurring gifts (e.g., for Christmas, birthdays and graduations).

Definitions:

Adjusted Gross Income: Under the federal income tax, the individual's income less various adjustments (e.g., Roth IRA contributions, alimony paid). Adjusted Gross Income is calculated before the itemized or standard deductions, exemptions and credits are taken into account.

Modified Adjusted Gross Income: Adjusted Gross Income plus foreign-earned income and tax-exempt interest.

Countable Income: For the purposes of determining Medicaid eligibility, income minus applicable disregards and deductions.

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