

Congress of the United States

JOINT COMMITTEE ON TAXATION

Washington, DC 20515-6453

OCT 13 2009

MEMORANDUM

TO: Cathy Koch and Mark Prater
FROM: Thomas A. Barthold *T.A.B.*
SUBJECT: 40-Percent Excise Tax on High Coverage Health Plans

This memorandum is in response to your request for information about the revenue estimate for the high cost premium excise tax in the amended Chairman's Mark of the "America's Healthy Future Act of 2009." In particular, you requested that we provide you with information regarding the incidence of the tax and our estimate of how much of the estimate is attributable to excise tax receipts.

Present law provides for exclusions from the individual income tax and from taxes under the Federal Insurance Contributions Act ("FICA") for employer contributions toward health insurance and health care for active and former (or retired) employees and their dependents. Present law does not limit the amount of employer-provided health benefits that may be excludable from income and FICA taxation. These exclusions also apply to employer contributions of up to \$3,000 for an individual and \$5,950 for a family in 2009 to health savings accounts ("HSAs") of employees, and to unlimited employer payments for health care through health reimbursement arrangements ("HRAs"). Active employees also may receive income and FICA tax exclusions for health insurance premiums paid through a section 125 plan by a salary reduction arrangement, and for out-of-pocket health care expenses paid through flexible spending arrangements ("FSAs").

Also under present law, for purposes of the individual income tax, self-employed individuals who purchase their health insurance may take an above-the-line deduction for the full amount of their health insurance premiums and those of their spouses and dependents. However, the deduction is not allowed for purposes of determining net earnings from self employment, and may not exceed the amount of self-employment income. The deduction is also not permitted for any month in which the self-employed individual is eligible to participate in an employer-subsidized health plan.

The Chairman's Mark as amended would impose an excise tax of 40 percent on the aggregate value of employer-sponsored health coverage and self-employed health coverage that exceeds a threshold amount (\$8,000 for individual coverage and \$21,000 for family coverage). Taxpayers who are over the age of 55 and retired, or who are covered by a plan that covers employees engaged in a high risk profession, would have their threshold increased by \$1,850 for

Congress of the United States

JOINT COMMITTEE ON TAXATION

Washington, DC 20515-6453

TO: Cathy Koch and Mark Prater
SUBJECT: 40-Percent Excise Tax on High Coverage Health Plans

Page 2

a single plan and \$5,000 for a family plan.¹ Employees considered to be engaged in a high risk profession are law enforcement officers, firefighters, members of a rescue squad or ambulance crew, and individuals engaged in the construction, mining, agriculture (but not food processing), forestry or fishing industries. Additionally, the modified Chairman's Mark would increase the threshold by 20 percent in 2013, 10 percent in 2014, and 5 percent in 2015 for individuals residing in the 17 highest cost States. The excise tax would be levied on a pro rata basis at the insurer and plan administrator (in the case of self-insured plans) level. The employer would be responsible for aggregating the amount subject to the excise tax allocable to each insurer and plan administrator and for reporting these amounts to each insurer, plan administrator and the IRS. Each insurer and plan administrator is then responsible for calculating, reporting and paying the excise tax. Employers who underreport the amount subject to the excise tax to insurers and plan administrators are generally subject to a penalty. The amount of the excise tax is explicitly not deductible for Federal income tax purposes. Further, the modified Chairman's Mark would index the thresholds and the increases to the thresholds by the percentage change in the general consumer price index ("CPI-U") plus one percent. Finally, the dollar thresholds would be applied ratably on a monthly basis.

Analysis of Incidence

An insurer offering a family health plan that exceeds the excise tax threshold, and is subject to the excise tax, faces an increase in the cost of offering that health coverage. Generally, we expect the insurer to pass along the cost of the excise tax to consumers by increasing the price of health coverage. In the extreme, the price would be increased by the full amount of the tax. For example, if the cost of a combination of health coverage offered by the employer were \$25,000 for a family plan, the plan would exceed the excise tax threshold by \$4,000. The insurer would be required to pay an excise tax of 40 percent of the \$4,000 excess, or \$1,600. In this example, we expect the insurer to pass along the increased cost of offering this plan to consumers, and the total cost of the \$25,000 plan would be \$26,600.

The imposition of the excise tax on insurers can be expected to lead health insurance providers and consumers to take measures to minimize their burden from the tax. As insurers pass along the cost to the consumer by increasing price, the cost of employer-provided insurance

¹ An individual's threshold cannot be increased by more than \$750 for individual coverage or \$2,000 for family coverage (indexed as described above), even if the individual would qualify for an increased threshold both on account of his or her status as a retiree over age 55 and as a participant in a plan that covers employees in a high risk profession.

Congress of the United States

JOINT COMMITTEE ON TAXATION

Washington, DC 20515-6453

TO: Cathy Koch and Mark Prater
SUBJECT: 40-Percent Excise Tax on High Coverage Health Plans

Page 3

will increase. Many employers share the cost of the insurance they provide with their employees; that is, the employer pays for some portion of the insurance premium, and the employee pays for some portion. To the extent that the increased cost of the insurance policy is paid by the employer, we would expect that would exert downward pressure on wages paid by the employer. To the extent that the increased premium cost is paid through the employee share, the added cost of the excise tax can be expected to reduce consumer demand for high cost insurance products. Over time, the downward pressure on wages attributable to the employer share of the increased cost would also reduce consumer demand for high cost insurance products.

We expect that consumers will seek less costly policies that would reduce their exposure to the excise tax. Cost reductions could be achieved through several strategies, ranging from managed care plans and limited provider networks to more out-of-pocket cost sharing by the consumers. When employers offer employees less costly plans, the employees will have less compensation in the form of non-taxable health care benefits and more in the form of cash compensation. In this case, the insurance consumer indirectly pays the tax as taxable income increases with the increased cash compensation.

It is possible that in some markets where the health insurance industry is not sufficiently competitive, there could be monopolistic pricing where any price change decreases profit. In this case, some of the excise tax could be absorbed by firms in the industry, reducing the profitability of the insurer.

The effects described above are not mutually exclusive. However, the staff of the Joint Committee on Taxation estimates that the excise tax would be mainly passed along through increases in premiums, and that many consumers respond by reducing their demand for insurance above the excise tax cap. As described above, because health insurance premiums are a component of compensation, which is not likely to fluctuate due to the excise tax, as consumers spend less on tax-excluded health benefits, their taxable cash wages will increase. Therefore, as the value of health insurance plans decline, the income tax base will increase in the long run.

For insurance plans costing less than the threshold for the application of the excise tax, the cost of offering the plan will remain the same to the firm because there is no tax on the plan. Although the demand for lower cost plans will rise for insurers, the cost of providing a lower cost health plan to any additional potential purchasers is not expected to be materially different from the cost of providing that plan to its existing customers of that plan, so demand for additional policies priced below the excise tax threshold would not be expected to exert significant pressure on the price of insurance below the excise tax threshold.

Congress of the United States
 JOINT COMMITTEE ON TAXATION
 Washington, DC 20515-6453

TO: Cathy Koch and Mark Prater
SUBJECT: 40-Percent Excise Tax on High Coverage Health Plans

Page 4

You requested that we provide you with the total revenue effects of premium excise tax as proposed in the Chairman's mark as amended. You also requested that we provide you with the revenues owing to excise tax receipts. The first three rows of the following table present the total revenue effects and the on and off budget amounts included in the total. The fourth row presents the net excise tax receipts from the proposal. We are also providing you with the percentage of health coverage benefits that are affected by the provision. As you can see in the table, other than the first year, the percentage owing to excise taxes is declining over the period, as consumers shift away from higher cost health coverage towards increased wage benefits. Also, you can see that the percentage of health benefits that are affected by the proposal is increasing over the period as the difference in inflation rates between CPI-U plus one percent and medical cost inflation binds on more taxpayers.

Revenue and Percentage Effects
Effects of 40% Premium Excise Tax [1]

<u>Item</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>2009-14</u>	<u>2009-19</u>
Total												
Revenues.....	---	---	---	9.5	17.7	23.2	29.5	34.9	40.3	46.3	27.3	201.4
On Budget...	---	---	---	7.6	14.2	18.5	23.5	27.8	31.8	36.4	21.7	159.8
Off Budget..	---	---	---	2.0	3.6	4.6	5.9	7.2	8.4	9.9	5.5	41.7
Net Excise Tax Receipts..	---	---	---	1.0	3.6	4.9	6.2	6.9	7.4	7.9	4.6	37.8
Percent of Premiums Affected.....	---	---	---	4%	6%	7%	8%	9%	10%	11%	N/A	N/A
Percent of Baseline Plans Above <u>Base</u> Threshold												
Single Plans.	---	---	---	19%	22%	24%	27%	29%	30%	34%	N/A	N/A
Family Plans	---	---	---	14%	18%	21%	25%	27%	29%	31%	N/A	N/A

NOTE: Details may not add to totals due to rounding.

[1] Revenue percentages are on a fiscal year basis, benefit percentages are on a calendar year basis, and tax effects are in billions of dollars.

N/A = Not Applicable