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JOHANNS AMENDMENT TO SMALL BUSINESS BILL WOULD RAISE HEALTH INSURANCE PREMIUMS, INCREASE THE RANKS OF THE UNINSURED, AND ELIMINATE PREVENTIVE HEALTH FUNDING

by Edwin Park and Chuck Marr

The Senate will vote tomorrow, September 14, on an amendment from Senator Mike Johanns (R-NE) to small business legislation that would repeal a provision of the health reform law designed to raise revenue by reducing noncompliance with the nation's tax laws.[1] While critics have raised legitimate concerns about some of the paperwork requirements related to that provision, policymakers can address those concerns by modifying the provision, rather than by repealing it outright and thereby allowing substantial tax avoidance to continue. Moreover, the Johanns amendment would offset the large revenue loss from repealing the tax compliance provision by eliminating critical funding for health prevention and by seriously weakening a key element of health reform, the requirement that individuals obtain health insurance or pay a penalty.

An alternative amendment from Senator Bill Nelson (D-FL), which the Senate will also consider on September 14, offers a far superior approach: significantly scaling back the tax provision to reduce its scope and its paperwork requirements, and making up for the lost revenue by reducing excessive tax subsidies and loopholes for oil companies, rather than by sharply cutting funding for preventive health efforts and weakening health reform.

Prior to enactment of the health reform law, businesses generally had to report to the Internal Revenue Service any payments of more than $600 they made to vendors for services they received; this reporting requirement was designed to help the IRS determine whether vendors were accurately reporting their income on their tax returns. Both the Government Accountability Office (GAO) and the IRS found, however, that the requirement was not sufficient to prevent a substantial number of vendors from significantly under-reporting their income in order to reduce their tax bills. A key problem was that the requirement *exempted* all payments to corporations, as well as all payments to vendors for goods and property rather than services.

The GAO, the IRS, and the Treasury Departments of both President Bush and President Obama all recommended strengthening the reporting requirement to remedy this problem. Accordingly, the health reform law (known as the Affordable Care Act) eliminated the current exemptions, requiring businesses to report payments of more than $600 to corporations and payments for goods and property (as well as for services). This new requirement is scheduled to take effect in 2012.

[1] S. Amdt. 4596 to the latest Senate substitute to H.R. 5297.

Some small businesses have expressed concerns that this change will impose a large paperwork burden and force them to track many additional expenditures, such as meals, gasoline, shipping, and store purchases. But repealing the provision entirely, as the Johanns amendment would do, would leave in place a clearly inadequate reporting regime that has failed to prevent widespread tax avoidance**.**

Repeal would also cause the loss of $17.1 billion in revenue over ten years (the amount of revenue that otherwise would be collected, due to the improved tax compliance that would result from the provision of the Affordable Care Act). To make up for this loss, the Johanns amendment would strip $11 billion in Affordable Care Act funding for critical investments in health prevention and related activities and would seriously weaken other aspects of the health reform law. These offsets raise serious concerns:

- **Eliminating preventive health funding.** Recognizing the importance of prevention strategies in improving health — and in reducing health care costs for the treatment of medical problems that could have been lessened or averted through preventive health practices — the Affordable Care Act established a Prevention and Public Health Fund, with dedicated funding of $15 billion over the next ten years (and $2 billion annually thereafter). The funding will be used for such activities as: testing new approaches to prevention and wellness; increasing state and local capacity to prevent, detect, and respond to outbreaks of infectious diseases; and facilitating community-based initiatives to prevent obesity, reduce tobacco use, and promote better nutrition and more physical activity. The Johanns amendment would eliminate *all* funding for the Prevention and Public Health Fund for fiscal years 2010-2017, taking away investments that could help reduce the incidence of chronic illness and infectious disease, improve overall health, and contain costs.

- **Weakening the individual mandate.** The requirement that individuals obtain health insurance or pay a penalty is necessary to the success of the Affordable Care Act's many popular, long-overdue insurance market reforms, such as prohibiting insurers from denying coverage to people with pre-existing medical conditions and from charging higher premiums to women and people with health problems. Those reforms will enable many people to gain coverage who are in poorer health and have been unable to purchase it.

  By themselves, however, those reforms would likely encourage some healthy people to wait to enroll until they became sick, since they would know they could obtain coverage when they became ill. As a result, the people newly enrolling in coverage would tend to be sicker than average and more costly to insure — which, in turn, would drive up premiums and thereby make coverage *less*, rather than more, affordable.

  The individual mandate avoids that problem by ensuring that a typical mix of both healthy and less-healthy individuals enrolls in coverage, which would keep premiums affordable. Without the individual mandate, the other reforms almost certainly will not be sustainable.

  The mandate has an exemption for people who would have to pay excessive amounts to purchase insurance — it allows people who would have to pay more than 8 percent of their income on premiums to remain uninsured without incurring a penalty. The Johanns amendment would lower the threshold to 5 percent of income. This change would exempt

large numbers of additional people from any penalty if they remained uninsured, and would lead to substantially fewer healthy people enrolling in coverage until they became sick, thereby driving up premiums and increasing the number of uninsured people.

The Congressional Budget Office and the Joint Committee on Taxation analyzed an earlier proposal to reduce the threshold from 8 percent to 5 percent and found it would increase the number of uninsured people by about 2 million (relative to what would occur with an 8 percent threshold) and increase premiums for coverage offered through the new health insurance exchanges by as much as 4 percent.

In addition, the increase in the number of people without coverage would push up *uncompensated care costs* that are borne by safety net hospitals, other health care providers, and state and local governments.

Change in Reporting Requirements Needed to Reduce "Tax Gap"

Overall, the compliance rate with the nation's tax laws is relatively high. It is particularly high when there is a real or virtual paper trail. With regard to wages, for example — where taxpayers are aware that each year their employer sends the IRS a copy of their W-2 form — compliance is a near-perfect 99 percent.

In contrast, the IRS estimates that sole proprietors (a popular filing status for small businesses) under-report their income by a stunning 57 percent, which means that, as a group, they pay taxes on *less than half* of their income.[2] As a result, *other* taxpayers have to pay *higher* taxes to make up for the lost revenue, and businesses that do *not* under-report are at a serious competitive disadvantage compared to businesses that do.

Federal law has long required persons engaged in a trade or business who make payments for services totaling at least $600 in a year to any one payee to report these payments to the IRS.[3] The purpose of this requirement is to produce documentation of payments that the providers of the services receive. Prior to the Affordable Care Act, however, the requirement exempted payments that businesses made to corporations rather than to individuals or non-corporate entities, as well as payments made for goods and property rather than services.[4]

The IRS and GAO, as well as the Treasury Department under both Presidents Bush and Obama, found this requirement inadequate and recommended broadening it to include payments to corporations, and the Bush administration proposed legislative action to address this problem in both of its last two budgets. The GAO stated in a 2009 report:

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[2] Internal Revenue Service, U.S. Treasury, "Reducing the Federal Tax Gap: A Report on Improving Voluntary Compliance," August 2, 2007, http://www.irs.gov/pub/irs-news/tax_gap_report_final_080207_linked.pdf.

[3] Carol A. Pettit and Edward C. Liu, "Form 1099 Information Reporting Requirements as Modified by the Patient Protection and Affordable Care Act," Congressional Research Service, August 6, 2010.

[4] Joint Committee on Taxation, "Technical Explanation of the Revenue Provisions of the 'Reconciliation Act of 2010,' As Amended, in Combination With the 'Patient Protection and Affordable Care Act,'" March 21, 2010, p. 113, http://jct.gov/publications.html?func=startdown&id=3673.

> We previously reported that the benefits [of extending reporting requirements to include payments to corporations] in terms of increased revenue and taxpayer compliance exceed costs. . . . IRS agrees that the benefits of this option in addressing the tax gap outweigh the costs. The Bush Administration requested legislative action in its fiscal year 2008 and 2009 budgets.[5]

The GAO has also noted that lack of information on businesses' payments for the purchase of merchandise or goods further weakens tax compliance.[6] For example, if a business pays a contractor to perform work, some of those payments will be for labor and some will be for materials, but the business reports *only* the payments for labor to the IRS, so the IRS lacks complete information on the contractor's true income.

The Affordable Care Act expanded the reporting requirement to include both payments to corporations and payments for goods and property. The Joint Tax Committee agreed that this would significantly improve tax compliance, estimating that it would increase revenues by $17.1 billion over the next ten years without any increase in tax *rates*, with the bulk of the revenue stemming from the goods and property component.

However, small business trade groups have expressed concerns about the additional reporting burdens, and the Senate is scheduled to debate and vote on two competing proposals upon its return in September:

- **Johanns amendment.** Senator Johanns proposes to repeal the entire Affordable Care Act provision. While the amendment's proponents can point to instances where the provision would prove burdensome, simply repealing it would leave in place a reporting regime that has been clearly demonstrated to be inadequate (given the large degree of noncompliance) and that harms small businesses which do not under-report their income. Repeal would also reject the recommendations of the IRS, the GAO, and the Treasury Department under Presidents from both parties.

- **Nelson amendment.** Senator Nelson has offered a balanced approach that responds to concerns over paperwork burdens while still strengthening tax compliance. On the most controversial aspect of the original provision — extending the reporting requirement to payments for goods and property — the amendment would exempt businesses with fewer than 25 employees and, for larger firms, significantly increase (from $600 to $5,000) the threshold for payments that must be reported. The amendment would also give the Treasury the regulatory flexibility to further limit the requirement both before and after its 2012 implementation.

  To avoid adding to budget deficits, the Nelson amendment would pay for this small-business relief by reducing the generous tax subsidies to very large, profitable oil companies.

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[5] Government Accountability Office, "Tax Gap: IRS Could Do More to Promote Compliance by Third Parties with Miscellaneous Income Reporting Requirements," January 2009, http://www.gao.gov/new.items/d09238.pdf.

[6] Government Accountability Office, "Tax Gap: A Strategy for Reducing the Gap Should Include Options for Addressing Sole Proprietor Noncompliance," GAO-07-1014, July 2007, http://www.taxcompliancefairness.org/NR/rdonlyres/eoafe53notvlbmghf6bdm3ulbscvxpm7xwayzr45jsdn6bjkpjwvjusva3eixrgvtqlsnik5ybhkj2zk24kxwm3j4nb/SoleProprietortaxgapGAO0710141.pdf.

Johanns Amendment Would Eliminate Funding for Prevention and Public Health

Not only would the Johanns amendment fail to address the need to improve tax compliance, but its provisions to offset its large cost would have serious implications for health reform.

The Prevention and Public Health Fund, which the Affordable Care Act established, makes significant new investments in prevention and public health programs. The funding will be used for a variety of activities, including prevention research, testing of new approaches to prevention and wellness, enhancement of the capacity of the public health infrastructure to respond to infectious disease outbreaks, immunization programs, and new initiatives like the Community Transformation Grants, which will fund community-based efforts to address preventable risk factors like obesity and tobacco use and to reduce racial and ethnic health disparities.[7]

For example, the Administration used the first $500 million in funding for fiscal year 2010 to support the following: federal, state and local initiatives to use evidence-based interventions in the areas of obesity prevention, tobacco cessation, HIV-related disparities, and better nutrition; the training and development of primary care professionals who frequently deliver preventive services; and a national campaign to prevent obesity and promote physical fitness.

The Johanns amendment would strip *all* funding for the Prevention and Public Health Fund for fiscal years 2010 through 2017, a reduction of $11 billion, to help offset the costs of repealing the information-reporting provision. That would take away needed investments to test and implement promising prevention and public health strategies that could improve health, reduce the incidence of both chronic and infectious disease, and help slow the rate of growth in health care costs.

Individual Mandate an Essential Complement to Insurance Market Reforms

The Affordable Care Act includes a number of popular insurance market reforms that will take effect in 2014. Among others, these reforms will bar insurers from denying coverage to people with pre-existing health conditions and charging higher premiums to women and people with health problems. The new law also sharply limits how much more insurers can charge older people than younger ones.

If instituted in isolation, however, these reforms would tend to drive up premiums due to the problem of "adverse selection," which occurs when the pool of people enrolled in various health insurance plans tends to be disproportionately sicker than the population as a whole. The people most likely to newly enroll in coverage after these insurance market reforms take effect would be those with pre-existing health conditions who had previously been unable to purchase health insurance and who need care right away. Moreover, if no changes other than these reforms were made, healthier people would become *less* likely to enroll because they could wait until they got sick before buying coverage. That would raise premiums, because less healthy individuals cost more to

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[7] Section 4002 of the Affordable Care Act. See also Congressional Research Service, "Public Health, Workforce, Quality and Related Provisions in the Patient Protection and Affordable Care Act (PPACA)," June 7, 2010.

treat, and thus more to insure. And in turn, higher premiums could cause even fewer healthy people to enroll in coverage, driving up premiums further.

To avoid this outcome, the Affordable Care Act requires most individuals to have insurance or pay a penalty. (People without access to affordable coverage — defined as those for whom health insurance premium costs would exceed 8 percent of family income — are exempt.) This "individual mandate" will discourage healthier people from waiting until they get sick to buy coverage and thus will help ensure that the people newly signing up for coverage represent a more typical mix of both healthy and less-healthy individuals. This will prevent premiums from spiraling out of control.[8]

According to M.I.T.'s Jonathan Gruber, widely considered one of the nation's leading health economists, eliminating the individual mandate while retaining the insurance market reforms and other elements of the Affordable Care Act (such as the subsidies to help individuals afford premiums) would drive up an individual's cost of coverage in the new health insurance exchanges dramatically, because fewer healthy people would enroll.[9]

Weakening the Mandate Would Increase Premiums and Number of Uninsured

While the Johanns amendment would not eliminate the mandate, it would weaken it very substantially by reducing the income threshold for the affordability exemption from 8 percent of income to 5 percent. That is, individuals and families who would have to pay at least 5 percent of their income on premiums could remain uninsured without a penalty. They could wait till they become sick to buy coverage.

Beginning in 2014, under the Affordable Care Act, uninsured people with incomes between 133 percent of the poverty line (the new Medicaid eligibility ceiling) and 400 percent of the poverty line who lack access to affordable job-based coverage will generally be eligible for subsidies to help pay for coverage through the health insurance exchanges. Under the Johanns amendment, individuals and families who are eligible for the subsidies could choose to forgo coverage and not pay a penalty if their subsidized premiums exceed 5 percent of income, as they would under the Affordable Care Act for many of these people. (People with incomes above 400 percent of the poverty line whose premiums would exceed 5 percent of their income also would become exempt. And people with access to employer-based coverage who are required to pay more than 5 percent of their income for their share of premiums would be exempt, as well, if they remained uninsured.)

In fact, this is precisely the amendment's intent. As noted, repealing the information-reporting requirements designed to reduce tax avoidance and improve compliance would reduce revenues by $17.1 billion over ten years. The part of the Johanns amendment that would enable people who would have to pay more than 5 percent of their incomes for health insurance premiums to remain uninsured without facing a penalty would cause a significant number of people with incomes between 133 percent and 400 percent of the poverty line to elect to remain without insurance. Since these people would not receive a tax-credit subsidy to help cover their premium costs, federal costs

[8] Shannon Spillane, "Key Health Insurance Market Reforms Not Achievable Without an Individual Mandate," Center on Budget and Policy Priorities, updated May 4, 2010.

[9] Jonathan Gruber, "Health Care Reform Is a Three-Legged Stool," Center for American Progress, August 2010.

for such subsidies would be lower. The Johanns amendment uses those savings to help pay for the loss in revenues that would result from the reduced compliance with tax laws that would result from its repeal of the information-reporting requirement.[10]

The Congressional Budget Office and the Joint Committee of Taxation estimated the effects of an earlier, identical proposal to reduce the affordability threshold under the individual mandate from 8 percent to 5 percent of income and found it would raise average premiums by up to 4 percent in the exchanges, because fewer healthy people would enroll.[11] The higher premiums would affect people who currently have individual market coverage but would enroll in the exchanges in 2014, as well as people who are uninsured now but would gain coverage in the exchanges and people who work for small employers that decide to purchase coverage through the exchanges (including firms that do not currently offer coverage). In 2009, a 4 percent increase in the overall average annual premium for an employer-sponsored plan would have added $535 a year to average premium costs.[12]

This increase in premiums, in turn, would cause still more people to qualify for the exemption from the penalty and thereby lead even more healthy people to remain uninsured — *further* increasing premiums for those who obtained coverage. Moreover, weakening the individual mandate could cause some insurers to elect not to offer coverage in the exchanges because of concerns that sicker people would end up disproportionately enrolling in exchange coverage; this would reduce competition among insurers on price and quality and limit choices for consumers. All of these effects would threaten the long-term viability of the exchanges to provide affordable, comprehensive coverage options to individuals and small businesses.

CBO estimates that by 2019, the Affordable Care Act will reduce the number of uninsured by 32 million, from an estimated 54 million who would be uninsured in the absence of reform. According to CBO and JCT, lowering the affordability threshold as the Johanns amendment would do would cause at least 2 million fewer people to gain coverage than would be the case under the health reform law as it now stands. (Between 1 million and 2 million fewer people would purchase individual coverage, and just under 1 million fewer people would enroll in employer-sponsored insurance and would instead remain uninsured.)

Cost of Treating More Uninsured Would Be Shifted to States, Hospitals, Providers

If more people have health coverage, the need to fund uncompensated hospital care for the uninsured will decline. In 2008, state and local governments shouldered $10.6 billion (nearly 20 percent) of the cost of caring for uninsured people in hospitals, according to Urban Institute research.[13] Anticipating a decline in the state and local cost of uncompensated care as the ranks of

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[10] Lowering the affordability exemption threshold to 5 percent is expected to produce savings of $8.9 billion over ten years. Congressional Budget Office and Joint Committee on Taxation, Communication with Bipartisan Congressional Staff on Senate Amendment No. 4325 (sponsored by Senator Pat Roberts [R-KS]), June 10, 2010.

[11] Congressional Budget Office and Joint Committee on Taxation, *op cit.*

[12] See Kaiser Family Foundation and Health Research and Educational Trust, "Employer Benefits: 2009 Annual Survey," September 2009.

[13] Jack Hadley, *et al.,* "Covering the Uninsured in 2008: Current Costs, Sources of Payment, and Incremental Costs," *Health Affairs,* August 25, 2008.

the uninsured shrink, the Affordable Care Act *reduces* federal assistance provided under the Medicaid Disproportionate Share Hospital program to hospitals that disproportionately serve the uninsured by $14 billion over ten years. It also reduces similar Medicare payments to hospitals serving low-income populations by $22 billion over ten years. Congress enacted these decreases on the assumption that health reform would reduce the number of uninsured by 32 million by 2019.

If Congress were now to weaken the individual mandate, the resulting increase in the number of people without insurance would leave hospitals with higher uncompensated care costs. These added costs would fall on safety net hospitals, other providers, and state and local governments.