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Special Series: Health Reform Issues

August 7, 2009

AN EXCISE TAX ON INSURERS OFFERING HIGH-COST PLANS CAN HELP PAY FOR HEALTH REFORM
Would Also Help Slow Growth in Health Costs

by Paul N. Van de Water

The federal government provides substantial tax subsidies for health insurance, especially for high-cost insurance plans for people with high incomes. The Senate Finance Committee is considering placing an excise tax on insurance companies that offer very high-cost health insurance plans. This proposal would help achieve two important objectives:

- It would provide a significant source of funding for subsidies to enable families of modest means to afford health insurance, thereby making the overall system of federal subsidies for health insurance more equitable. (See the box on page 4.)

- It would contribute to slowing the rate of growth of health insurance and health care costs.

As a result, the proposal merits serious consideration.

The proposed excise tax would be levied on health insurance companies and third-party administrators that offer health insurance plans with premiums that exceed a specified amount. The threshold for the tax might range from $8,000 to $10,000 for a single health insurance policy and $21,000 to $25,000 for a family policy starting in 2013, according to press reports.[1] At those thresholds, the vast majority of health insurance plans would be unaffected (as explained in more detail below).

The tax would equal a percentage of the amount by which premiums exceeded these thresholds. In years after 2013, the thresholds would rise to keep pace with overall inflation, the growth in health care prices or spending, or some blend of the two. (Information is not available on exactly how the indexing would work.) For insurance companies that sell health insurance to individuals or small groups, the excise would be based on the actual premiums paid. For large employers that act as their own insurer, the excise would be based on the premiums charged to former employees

[1] Anna Edney, "CBO: Senate Finance Draft Costs $900B," *Congress Daily PM*, July 29, 2009; Carl Hulse and Robert Pear, "Senators Progress as House Delays Again on Health Bill," *New York Times*, July 28, 2009.

eligible for continuation of coverage under the Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA).

Consider, for example, an excise tax of 35 percent on insurers offering family policies that cost more than $21,000. An insurer offering family policies that cost $21,000 or less would pay no tax. If a policy cost $22,000, the insurer would pay $350 (35 percent of the $1,000 excess over $21,000) per policy. For a policy that cost $25,000, the insurer would pay $1,400 (35 percent of $4,000).

An excise tax on insurers offering high-cost plans can provide a significant source of financing for health reform. Health reform legislation that seeks to attain universal coverage is likely to cost some $1 trillion over 10 years. The White House has consistently stated that the legislation must be fully paid for. It announced on June 1 that "we are insisting that health reform be deficit neutral over the next five to 10 years, through scoreable offsets." Office of Management and Budget Director Peter Orszag declared that this requirement "is ironclad, no ambiguity, not up for negotiation."[2]

The proposal to tax insurers offering high-cost plans would apparently raise about $90 billion to $180 billion in revenues over 10 years depending on where the thresholds are set, how they are indexed, and what tax rate is applied. Other revenue options also merit strong consideration — for example, maintaining the current value of itemized deductions for high-income taxpayers or placing an income tax surcharge on high-income individuals, as included in the House health reform bills, though Senate Finance negotiators have apparently rejected these approaches.[3]

The remaining revenue provisions that the Finance Committee is discussing, along with savings from Medicare and Medicaid, will likely fall well short of paying for health reform that achieves universal or near-universal coverage that is affordable to families of modest means. As a result, if the proposed excise tax on insurers is not adopted, the Senate Finance Committee will be faced with making cutbacks elsewhere in the bill, such as in the subsidies for families with modest incomes, which may already be insufficient to make health insurance affordable for large numbers of low- and moderate-income Americans.[4]

The vast majority of health insurance plans would be unaffected by the proposal. The typical American's health insurance costs far less than the level that would trigger the tax. In 2008, the average employer-sponsored health insurance plan was valued at $4,704 for a single individual and $12,680 for a family.[5] In the same year, the health insurance plan most commonly chosen by federal employees, including Members of Congress, cost $5,387 for individual coverage and $12,335

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[2] See Peter R. Orszag, "A Belt and Suspenders Approach to Fiscally Responsible Health Reform," June 1, 2009, http://www.whitehouse.gov/omb/blog/09/06/01/ABeltandSuspendersApproachtoFiscallyResponsibleHealthReform, and Jonathan Weisman, "Jittery Bond Market Threatens President's Agenda," *Wall Street Journal*, May 30, 2009.

[3] Chuck Marr, *House Health Bill's High-Income Surcharge: A Reasonable Approach*, Center on Budget and Policy Priorities, July 30, 2009; Chuck Marr, *Maintaining Current Value of Itemized Deductions for High-Income Taxpayers Could Help Pay for Health Care Reform: Move Would Save $68 Billion Over Ten Years*, Center on Budget and Policy Priorities, June 10, 2009.

[4] Judy Solomon, *Senate Finance Committee Faces Difficult Choices in Lowering Cost of Health Bill: Subsidy Changes Could Leave Some without Affordable Coverage*, Center on Budget and Policy Priorities, July 1, 2009.

[5] Kaiser Family Foundation and Health Research & Educational Trust, *Employer Health Benefits: 2008 Annual Survey*. The figures cited exclude the cost of coverage for retired workers.

for a family.[6] Allowing for the projected growth in overall health spending, about 90 percent of people in family plans will have premiums of less than $21,000 in 2013 (the equivalent of about $16,800 in 2008).[7] At the $21,000 level, a plan would be about one-third more generous than the plan that Members of Congress have. If the threshold were set at $25,000, it would exceed the premium level for Members of Congress by a very large amount and affect plans that fewer than 5 percent of Americans have. Depending upon the method selected for indexing the thresholds, a somewhat larger proportion of health insurance plans could be affected in later years.[8]

The proposal would not affect the cost of health insurance for most people. Insurers generally would pass on the cost of the excise tax to employers and workers in the form of higher premiums for the high-cost insurance plans that would be subject to the tax. The excise would give employers and employees with plans exceeding the thresholds for taxation an incentive to avoid the tax by moving toward more efficient or less expensive — but still comprehensive — coverage, and insurers would be encouraged to offer less costly plans. People with insurance plans below the thresholds would be unaffected. An insurer that offered both high- and low-cost plans generally could *not* increase premiums for both types of products, since it would have to compete for business with insurance companies that offered only low-cost plans not subject to the tax.

The high-cost health insurance plans affected by the tax offer unusually generous benefits that are not available to most Americans. What kinds of benefits do very high-cost insurance plans offer? The executive medical and dental program at Goldman Sachs, one of the nation's largest banks, has become the poster child for lavish health insurance plans. Goldman's top executives participate in a medical and dental plan that costs $40,543 a year for each participant's family — *over three times* the national average — according to the *New York Times*. Paul Fronstin, director of the health research and education program at the Employee Benefit Research Institute, suggests that such extremely expensive plans are likely to have *no* co-payments or deductibles, *no* limits of virtually any sort on doctors or procedures, and *no* requirements for referrals.[9]

As another example, the *Boston Globe* recently described a plan that costs $20,400 a year for family coverage, about 60 percent above the national average. The plan provides $450 annually towards gym memberships, or $200 for home exercise equipment, and $150 for yoga classes or nutritional counseling.[10] It also requires no cost sharing for many procedures and services and only modest cost sharing for others. Depending on where the threshold is set, such a plan would either escape the tax entirely or be touched only lightly.

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[6] U.S. Office of Personnel Management, "Non-Postal Premium Rates for the Federal Employees Health Benefits Program," http://www.opm.gov/insure/health/rates/nonpostalffs2009.pdf, accessed August 4, 2009. Premiums for Blue Cross Blue Shield standard option.

[7] Kaiser Family Foundation, personal communication, and author's calculation.

[8] Possible indexes include the annual growth rate of national health expenditures (NHE) per person, the gross domestic product (GDP) per person, the medical component of the Consumer Price Index (CPI), or the overall CPI. Between 1990 and 2007, NHE per person grow by 5.9 percent per year, the medical CPI by 4.6 percent, GDP per person by 3.7 percent, and the overall CPI by 2.8 percent. If the thresholds grow more slowly than health insurance premiums, somewhat more plans will become subject to the excise tax over time. If that is done, the measure also will raise more revenue over time and exert more pressure over time to slow the growth of health insurance premiums and health care costs.

[9] Leslie Wayne and David M. Herszenhorn, "A Bid to Tax Health Plans of Executives," *New York Times*, July 27, 2009.

[10] Lisa Wangsness, "Healthcare overhaul could limit tax breaks on benefits," *Boston Globe*, July 4, 2009.

People with high-cost health insurance plans such as these now receive substantial federal subsidies — especially if they are in high income-tax brackets — because, unlike most other forms of compensation, employer-provided health insurance benefits are excluded from an employee's taxable income for purposes of both income and payroll taxes. Placing an excise tax on insurers offering high-cost plans would generate revenues that could ensure more adequate health insurance subsidies for those who need them most, and thereby help to shrink the number of uninsured.

A Clear Choice on Federal Subsidies

The debate over the merits of taxing high-cost, excessively generous insurance plans has highlighted Goldman Sachs's plan as an example. Goldman's 400 managing directors reportedly receive an average of $40,543 in employer-provided health insurance annually. What has received less attention is how much of the cost the federal government pays. This compensation is provided tax-free. The same result would occur if the compensation were included as income and the government *sent each Goldman managing director a check for $14,777 each year*.

For comparison, consider an illustrative family of three in which the father earns $30,000 as an independent contractor for a small plumbing company and the mother earns $25,000 from a small retailer. Neither small business provides health benefits. The couple has a daughter in second grade at the local public school and pays $100 a week for child care after school and during the summer. The family lives in a modest home and pays $1,000 a month in rent and $250 in utilities. It owes $2,312 in federal income taxes, $6,502 in Social Security and Medicare taxes, and $1,350 in state income taxes. It has two cars with payments of $300 a month each, and pays $2,000 a year in car insurance and $1,000 a year for gasoline. It spends $150 a week on groceries. The couple has avoided accruing any credit card debt, but they have no saving for retirement and no life insurance.

After paying these basic expenses, this typical family would have a little *less than $500 a month* to cover any costs for clothes or shoes, car repairs or maintenance, household expenses, restaurant meals, and any hobbies or activities — *and all of the family's health expenses*.

Right now, the federal government pays $14,777 to provide health insurance for each of Goldman Sachs's managing directors and pays nothing to provide health insurance for this middle-income family. The Administration and Congress face a clear choice: can we modestly reduce the extremely generous government subsidies provided to the Goldman bankers and others similarly situated to help pay for a subsidy worth a fraction of that amount to families of modest means?

The proposal would not undermine employer-sponsored health insurance. In the context of comprehensive health reform, taxing insurers that offer very high-cost plans can provide a significant source of financing while leaving in place most of the substantial existing tax incentives for employer-sponsored coverage. In addition, all of the leading health reform proposals, including the one that the Senate Finance Committee is developing, include a requirement that individuals obtain health insurance for themselves and their families. This requirement is important: faced with such a requirement, many workers would find employer-sponsored health insurance more attractive

than it is now, even if a small minority of them had to pay taxes on a modest fraction of the benefit. Employers would have every reason to continue offering health insurance, and employees would have every incentive to accept the offer. In Massachusetts, the individual mandate has resulted in an increase in employer-sponsored coverage. Employment-based insurance contracts have also proved popular in the Netherlands, which has an individual mandate.

Furthermore, the Finance Committee proposal (like the proposals reported by the Senate Committee on Health, Education, Labor, and Pensions and by three committees in the House of Representatives) is expected to include a requirement that firms of more than a certain size pay a penalty of some sort if they do not offer insurance to their employees. Such a requirement would discourage employers from dropping health coverage if high-cost plans become partly taxable.

The proposal will likely be designed to protect insurance plans in states with unusually high health care costs and can also be designed to protect employers with an older workforce. One health insurance plan can have higher costs than another *not* because it provides more generous benefits but because it covers workers who live in an area with higher health care spending and insurance costs, or who are older than average. To protect plans in states with high health care costs, the proposal will likely set a higher threshold for the application of the excise tax in high-cost states, at least during a multi-year transitional period. The proposal could also be designed to apply a higher threshold to firms with significantly older-than-average workforces.

Taxing insurers that offer high-cost plans can help to slow the growth of health care costs and health insurance premiums. Congressional Budget Office Director Douglas Elmendorf has indicated that limiting the favorable tax treatment of high-cost health insurance could be one of the most effective ways of bending the rising curve of health care costs. The proposed excise tax on high-cost plans would discourage insurers from offering, and firms from purchasing, extremely generous health insurance coverage that encourage excess health care utilization. That, in turn, would reduce incentives for excessive health care spending and ultimately could contribute to making health care and health coverage more affordable for Americans generally.