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TAX OFFSETS IN BAUCUS HEALTH PLAN ARE SOUND BUT CAN BE IMPROVED

By Chuck Marr and Paul Van de Water

The health reform proposal by Senate Finance Committee Chairman Max Baucus would place a 35-percent excise tax on the value of health plans in excess of \$8,000 for singles and \$21,000 for families, starting in 2013; these thresholds would be indexed for inflation in later years. The excise tax is a sound way to help pay for health reform, but it has some shortcomings that can and should be addressed. Policymakers should modify the proposal to avoid unfairly affecting firms with older — and hence less healthy — workforces and to keep the “reach” of the tax from expanding too much.

Protecting Firms with Less Healthy Workforces and Limiting Number of Plans Affected

The federal government provides more than \$250 billion each year in health care subsidies by excluding the value of employer-sponsored health insurance from individuals’ taxable income. These subsidies are the largest for high-income individuals who are enrolled in the most generous and costly health plans. The excise tax in the Baucus plan would reduce the subsidies’ cost to the government.

The vast majority of plans would be unaffected by the tax: we estimate that in 2013, fully 90 percent of family plans will have premiums below \$21,000. A plan costing \$21,000 would be about *one-third more generous* than the plan that most Members of Congress have.

Some health insurance plans, however, have high costs not because they provide very generous benefits but because they cover workers who are older than average. Older workers tend to be less healthy and thus costlier to insure than younger workers. In fact, age may be the single biggest reason why some plans’ enrollees are less healthy than others’, on average.

To protect plans that cover a disproportionate number of older workers, including retirees who are not yet eligible for Medicare, the thresholds for applying the tax should be higher for these plans than the standard thresholds (which, as noted, would be \$8,000/\$21,000 in 2013).¹ Raising the

¹ Paul N. Van de Water, *An Excise Tax on Insurers Offering High-Cost Plans Can Help Pay for Health Reform*, Center on Budget and Policy Priorities, August 7, 2009.

thresholds for these plans would lose less revenue than raising the thresholds across the board, thereby helping preserve resources badly needed to help low- and moderate-income people buy coverage. (Even at their current levels, the subsidies in the Baucus proposal are insufficient to make health care affordable for many low- and moderate-income families.²) By the same token, if policymakers are aiming to forgo a certain amount of the revenue that the excise tax as now designed would raise, they could use that money more effectively by directing it toward plans that enroll a large proportion of older workers and retirees rather than spreading it more thinly across plans generally.

In addition, because health care costs tend to rise more rapidly than other prices, it would be desirable to index the thresholds for the tax at a somewhat higher rate than overall consumer price inflation. Doing so would prevent the reach of the tax from expanding too rapidly over time and affecting too many health insurance plans.

Offsetting the Cost of These Improvements

The excise tax in the Baucus proposal would generate \$215 billion over ten years, according to the Joint Tax Committee.³ The improvements discussed above would likely reduce this revenue estimate modestly. Such improvements will need to be paid for so that the plan's already insufficient subsidies are not scaled back still more. One offset with particular merit would be to maintain the *current* value of itemized deductions for taxpayers with the highest incomes.

Currently, the federal government subsidizes the itemized deductions of people at the top of the income scale at a higher rate than people in the middle because the former are in higher tax brackets. (Put another way, the government does more to help a banker than a teacher to buy a house.) This inequity is scheduled to worsen in 2011 when the top two rates increase from 33 and 35 percent to 35 and 39.6 percent, respectively. Holding the value of itemized deductions at their current rates of 33 and 35 percent for people in the top two tax brackets would raise between \$68 billion and \$89 billion⁴ between 2010 and 2019 while still providing high-income taxpayers with the *same tax incentives they receive today* to buy a house, contribute to a charity, or incur other deductible expenses.⁵

This revenue should more than cover the cost of the excise tax improvements proposed above, with the result that the remaining amount could be used to improve the subsidies in the Baucus proposal.

² January Angeles, *Subsidies in Baucus Health Reform Plan Would Fall Short of What Is Needed for Many People to Afford Health Care*, Center on Budget and Policy Priorities, September 16, 2009.

³ Joint Committee on Taxation, *Estimated Revenue Effects of the Revenue Provisions Contained in the Chairman's Mark of the "America's Healthy Future Act of 2009,"* September 16, 2009.

⁴ Brookings Institution-Urban Institute Tax Policy Center, *Alternatives to the Administration's 28-Percent Limitation on Itemized Deductions*, June 4, 2009, <http://www.taxpolicycenter.org/numbers/displayatab.cfm?DocID=2401>.

⁵ Chuck Marr, *Maintaining Current Value of Itemized Deductions for High-Income Taxpayers Could Help Pay For Health Care Reform*, Center on Budget and Policy Priorities, June 10, 2009.