

TAXING HEALTH CARE TO PAY FOR HEALTH CARE?

The two most important issues surrounding Health Care Reform are who will pay for it and should there be a public plan? It is safe to assume that a public health plan will be provided to the currently uninsured. Our focus is the impact that taxing health care will have on working Americans currently covered by employer provided health plans. Taxing health care will cost you more money and will eliminate FSAs and HRAs—account-based plans you use to manage your health care costs.

On May 20, 2009, the Senate Finance Committee released policy options for financing Health Care Reform. These options included taxing health care premiums and eliminating FSAs, HRAs, and other pre-tax medical benefits. If the proposed financing options become law, working Americans will pay drastically more for their health care needs. How much more? For example, let's consider a family earning \$35,000 a year with \$12,000 in medical premiums and puts \$3,000 into their FSA. The employer agrees to pay \$7,000 of their medical premiums and the employee pays the remaining premium with pre-tax pay check deductions. Below is a breakdown with and without the tax break:

TAX FREE HEALTH CARE

Currently, the insurance premium paid by your employer is excluded from your taxable income. Any medical premiums you pay and contributions made to your FSA are deducted pretax.

Gross Pay	\$35,000
<u>Medical Costs*</u>	<u>\$8,000</u>
Taxable Income	\$27,000
<u>Estimated Taxes</u>	<u>\$5,280</u>
Take Home Pay	\$21,720

*Employee portion of medical premium and FSA contributions.

TAXING HEALTH CARE

Without the tax break the portion of your insurance premium paid by your employer will be included in your taxable income. Employer paid premiums, your portion of the premium, and out-of-pocket medical costs that you would have put into your FSA will now be taxed.

Gross Pay	\$35,000
<u>Employer paid premium</u>	<u>\$7,000</u>
Taxable Income	\$42,000
Estimated Taxes	\$8,678
Income after tax	\$26,322
<u>Remaining Medical Costs*</u>	<u>\$8,000</u>
Take Home Pay	\$18,322

*Employee portion of medical premium and FSA contributions.



**THAT'S A \$3,398 TAX
INCREASE TO PAY FOR
A PLAN YOU DON'T
PARTICIPATE IN!**

As you can see, taxing health care will negatively impact working Americans and their families. This could be the largest income tax on Americans in the history of the United States. Additionally, employers will think twice about offering health insurance to their employees when the tax incentive disappears.

Below is more information and analysis on preserving the current tax break and safeguarding Health FSAs and HRAs.

THE EXCLUSION FOR EMPLOYER-PROVIDED HEALTH COVERAGE

INCREASED COST TO EMPLOYEES AND THEIR FAMILIES

Any limit to the employer exclusion would significantly increase the cost of health care to employees. Each year, employers carefully consider their health care coverage options and are already exposing employees and their families to the rising costs of coverage. The employer exclusion doesn't just benefit employers, employees and their families benefit from the exclusion because the amount of premiums paid by the employer and any portion paid by the employee is excluded from the employee's income for income tax purposes and excluded from wages from payroll tax purposes. A limit to the employer exclusion would mean an increase in the cost of coverage to employees by potentially more than 40% (7.65% FICA and between 10% and 35% federal income tax). During these uncertain economic times Americans cannot shoulder such a severe tax increase or endure further weakening of individual financial confidence.

INCREASED COSTS TO THE EMPLOYER AND NEGATIVE IMPACT ON THE ECONOMY

Employer-provided health coverage is the leading source of coverage for Americans today. Currently employers provide coverage to 160 million employees, spouses, and dependents. The exclusion allows those employers to pay their portion of their employees' premiums pre-tax; meaning that the employer does not pay FICA or FUTA. Any limit on the exclusion would increase health care costs to employers, particularly small business which comprise of 99.7% of all employers and 75 percent of the net new jobs in our economy. *U.S. Small Business Administration*. An increased tax burden on employers would financially stress small business with already narrow margins, destabilize the current private market, and impede job growth at a time when we need it most.

EMPLOYERS MAY STOP PROVIDING COVERAGE LEAVING EVEN MORE INDIVIDUALS UNINSURED

Employers are already financially strained, a limit or modification to the exclusion would equate to a significant tax increase in the amount of FICA and FUTA currently avoided. Employers are not required to provide health care coverage for their employees and an increase in the cost of health coverage would cause many employers to stop providing coverage—leaving even more individuals uninsured, a contrary consequence to the goals of health care reform.

ADVERSE SELECTION AND ACROSS THE BOARD HEALTH CARE COST INCREASES

Another consequence of limiting the exclusion is that healthy employees, faced with higher premiums, will leave the employer-provided plan. Healthy employees are more likely to engage in a cost benefit analysis and potentially drop coverage or chose the less expensive government-sponsored plan thereby leaving unhealthy people in the employer plan. This adverse selection will further increase the costs of health care because more unhealthy people will remain, utilizing more of the benefit while healthy individuals leave—meaning fewer healthy individuals to subsidize the sick and balance the pool of risk. Finally, we should tread carefully before promoting any quasi-Medicare type plan as a component of health care reform. There is serious doubt as to Medicare's sustainability as it is slated for insolvency by 2017.

THE EXCLUSION FOR EMPLOYER-PROVIDED REIMBURSEMENT OF MEDICAL EXPENSES UNDER AN FSA OR HRA

The Senate Finance Committee has proposed options for financing health care reform by placing a limit or eliminating entirely FSAs and HRAs. These plans allow employers to reimburse employees out-of-pocket medical expenses listed under 213d of the Internal Revenue Code on a pre-tax basis. Employer and employee contributions to an FSA and employer contributions to an HRA are excluded from income for income tax purposes and excluded from wages from payroll tax purposes. FSAs and HRAs promote a consumer driven approach to the consumption of health care and aid those who need it most, families and the sick.

FSA AND HRA PLANS PROMOTE CONSUMER LIKE CHOICES AND REDUCE THE COSTS OF HEALTH CARE

FSAs and HRAs provide employers with cost sharing mechanisms that ultimately reduce the long-term costs of health care. The current system isn't subject to traditional market-based rules; we have a three-party system consisting of the consumer, provider, and insurer. In a three-party system consumers don't automatically choose health care based on cost. Exposure to medical costs, like coinsurance, copays, and deductibles cause employees to make consumer-like choices. FSAs and HRAs make cost sharing more affordable and incentivize consumers to make financially prudent health care choices—reducing utilization and ultimately reducing the costs of health care.

MODIFICATION OR REPEAL OF FSA AND HRA PLANS WOULD BURDEN FAMILIES AND THE SICK

Placing a limit on FSAs or HRAs would financially strain those who need and use these benefits most, families and the sick. Employers are placing downward pressure on the rising costs of premiums by choosing high-deductible health plans, plans with higher copayment thresholds, and plans with higher coinsurance percentages. The impact of these increased costs falls on families and the sick as they are more likely to use their health care benefits. Any limit or repeal of FSAs or HRAs would disproportionately burden families and the sick. Additionally, families and the sick who cannot afford health care may forego coverage or necessary care the effects of which would weigh on the productivity of society. Tax advantaged plans don't just benefit the individuals enrolled in the plan; they promote conscientious consumers and a physically and financially healthy society.

SUMMARY

One goal of health care reform is to provide coverage to all individuals. But the solution to providing coverage to all cannot be solved by focusing on the problem in a vacuum. There are aspects of the current model that work, and for 160 million working American's and their families the employer exclusion and FSAs and HRAs are the only means to affordable health care coverage.