



## CONGRESSIONAL BUDGET OFFICE COST ESTIMATE

August 30, 2005

### **H.R. 994**

#### **A bill to amend the Internal Revenue Code of 1986 to allow federal civilian and military retirees to pay health insurance premiums on a pretax basis and to allow a deduction for TRICARE supplemental premiums**

*As reported by the House Committee on Government Reform on June 16, 2005*

#### **SUMMARY**

H.R. 994 would modify the tax treatment of certain health insurance premiums paid by federal civilian retirees and by active-duty and retired military personnel. It would allow federal civilian and military retirees to pay for health insurance premiums on a pre-tax basis when those premiums are paid through a pension reduction arrangement. It also would allow active-duty and retired military personnel to deduct certain supplemental premiums or enrollment fees for TRICARE, the military's health care program, from their taxable income.

The Joint Committee on Taxation (JCT) estimates that enacting the legislation would reduce federal revenues by \$561 million in 2006, about \$4.6 billion over the 2006-2010 period, and about \$12.7 billion over the 2006-2015 period. The Congressional Budget Office (CBO) estimates that enacting the bill would increase direct spending by \$4 million in 2006, and by about \$600 million over the 2006-2015 period. CBO also estimates that implementing the bill would cost \$1 million in 2006, assuming the availability of appropriated funds.

CBO anticipates that allowing civilian retirees to pay for health insurance with pre-tax dollars would slightly increase participation by new retirees in the Federal Employees Health Benefits (FEHB) program. It may also cause retirees to switch to more generous (and more expensive) health plans. Federal contributions toward health premiums for federal civilian retirees are classified as direct spending in the budget. We estimate that enacting the bill would increase direct spending by the federal government for its share of annuitant premiums by about \$600 million over the 2006-2015 period.

Pursuant to section 407 of H. Con. Res. 95 (the Concurrent Resolution on the Budget, Fiscal Year 2006), CBO estimates that enacting H.R. 994 would cause an increase in direct spending greater than \$5 billion in all of the three 10-year periods beginning after 2025.

JCT has determined that the tax provisions of H.R. 994 contain no intergovernmental or private-sector mandates as defined in the Unfunded Mandates Reform Act (UMRA). CBO has determined that the non-tax provisions of this bill contain no new private-sector mandates as defined in UMRA. CBO has further determined that the non-tax provisions contain no intergovernmental mandates as defined in UMRA and would impose no costs on state, local, or tribal governments.

## **ESTIMATED COST TO THE FEDERAL GOVERNMENT**

The estimated budgetary impact of H.R. 994 is shown in the following table. The costs of this bill fall within budget functions 050 (national defense), 550 (health), and 600 (income security).

## **BASIS OF ESTIMATE**

For purposes of this estimate, JCT and CBO assumed that H.R. 994 will be enacted near the start of fiscal year 2006.

## **Revenues**

The Joint Committee on Taxation has provided an estimate of the revenue effects of H.R. 994. In total, JCT estimates that enacting the bill would reduce governmental receipts by \$561 million in 2006, about \$4.6 billion over the 2006-2010 period, and about \$12.7 billion over the 2006-2015 period.

By Fiscal Year, in Millions of Dollars

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
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**CHANGES IN REVENUES**

Exclusion for FEHB Premiums Paid By Federal Civilian Retirees	-509	-775	-848	-925	-1,005	-1,207	-1,359	-1,472	-1,595	-1,728
Exclusion for TRICARE Prime Premiums Paid By Military Retirees	-22	-33	-35	-36	-36	-40	-42	-42	-42	-41
Exclusion for TRICARE Dental Premiums Paid By Military Retirees	-27	-41	-46	-50	-54	-65	-73	-79	-85	-92
Deduction for TRICARE Supplemental Insurance Premiums Paid By Active-Duty and Retired Military Personnel	<u>-4</u>	<u>-24</u>	<u>-27</u>	<u>-30</u>	<u>-32</u>	<u>-35</u>	<u>-43</u>	<u>-45</u>	<u>-49</u>	<u>-52</u>
Estimated Revenues	-561	-873	-956	-1,040	-1,128	-1,348	-1,516	-1,638	-1,770	-1,913

**CHANGES IN DIRECT SPENDING**

Office of Personnel Management <sup>a</sup>										
Estimated Budget Authority	1	0	0	0	0	0	0	0	0	0
Estimated Outlays	1	0	0	0	0	0	0	0	0	0
Federal Employees Health Benefits Program										
Estimated Budget Authority	3	13	23	33	46	59	75	92	111	133
Estimated Outlays	3	13	23	33	46	59	75	92	111	133
Total Changes										
Estimated Budget Authority	4	13	23	33	46	59	75	92	111	133
Estimated Outlays	4	13	23	33	46	59	75	92	111	133

**CHANGES IN SPENDING SUBJECT TO APPROPRIATION**

Department of Defense										
Estimated Authorization Level	1	0	0	0	0	0	0	0	0	0
Estimated Outlays	1	0	0	0	0	0	0	0	0	0

SOURCES: Joint Committee on Taxation and CBO.

NOTES: Details may not add to totals because of rounding.

FEHB = Federal Employees Health Benefits program.

TRICARE refers to the military's health insurance program.

a. Amounts reflect OPM's administrative costs to implement a premium conversion program for annuitants. Expenses arising from administering income tax withholding on retirement benefits are considered direct spending.

Most of the reduction in revenues would result from excluding from taxable income the portion of pension income of federal civilian retirees that is withheld to pay the retiree share of premiums for health insurance coverage under the Federal Employees Health Benefits program. JCT estimates that doing so would decrease federal revenues by \$509 million in 2006, about \$4.1 billion over the 2006-2010 period, and about \$11.4 billion over the 2006-2015 period. The bill also would provide similar income tax exclusions for military retirees for TRICARE Prime and TRICARE Dental premiums. Together, providing those exclusions would decrease governmental receipts by about an additional \$979 million between 2006 and 2015. Lastly, H.R. 994 would allow active-duty and retired military personnel to deduct TRICARE supplemental premiums from taxable income, which JCT estimates would reduce federal revenues by about \$341 million over the 2006-2015 period.

## **Direct Spending**

H.R. 994 would increase administrative costs for the Office of Personnel Management (OPM) to implement the new premium conversion program for annuitants. Because CBO expects that the bill likely would affect choices by retirees concerning the purchase of health insurance, we also expect that it would increase spending by the federal government for its share of retiree health premiums.

**Office of Personnel Management.** In order to implement the provisions of H.R. 994, OPM would incur additional administrative costs to notify retirees of the new benefit and change their computer systems to accommodate the new tax treatment of beneficiaries' benefits. Based on information provided by OPM, CBO estimates this would increase the agency's expenses by \$1 million in 2006. While most administrative spending by OPM is subject to appropriation, expenses arising from administering income tax withholdings on retirement benefits are considered direct spending.

**Federal Employees Health Benefits program.** Allowing federal civilian retirees to pay for health insurance premiums on a pre-tax basis would reduce the effective cost of health insurance for retirees. CBO expects that such a benefit would generate a small increase in the number of new retirees who participate in the FEHB program at retirement. In addition, CBO anticipates that some retirees may switch from their current health coverage to more-generous (and more-expensive) plans to take advantage of the increased buying power of their contributions toward health insurance. Such changes would increase spending by the federal government for its share of retiree health premiums. (Federal contributions toward retiree premiums are classified as direct spending in the budget.) CBO estimates that enacting the bill would increase direct spending by the federal government for its share of FEHB premiums for retirees by \$3 million in 2006, by about \$100 million over the 2006-2010 period, and by about \$600 million over the 2006-2015 period.

## **Spending Subject to Appropriation**

As with OPM, the Department of Defense (DoD) would incur additional administrative costs primarily to notify retirees and active-duty personnel of the new benefit and to reflect the special tax treatment of enrollee contributions toward qualified expenses in their data systems. Based on information from DoD, CBO estimates that such activities would cost DoD about \$1 million in fiscal year 2006, assuming the availability of appropriated funds.

## **ESTIMATED LONG-TERM EFFECTS ON DIRECT SPENDING**

Pursuant to section 407 of H. Con. Res. 95 (the Concurrent Resolution on the Budget, Fiscal Year 2006), CBO estimates that enacting H.R. 994 would cause an increase in direct spending greater than \$5 billion in all of the three 10-year periods beginning after 2025.

## **INTERGOVERNMENTAL AND PRIVATE-SECTOR IMPACT**

JCT has determined that the tax provisions of H.R. 994 contain no intergovernmental or private-sector mandates as defined in UMRA. CBO has determined that the non-tax provisions of this bill contain no new private-sector mandates as defined in UMRA. CBO has further determined that the non-tax provisions contain no intergovernmental mandates as defined in UMRA and would impose no costs on state, local, or tribal governments.

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