



June 23, 2014

Coverage Effects of Limiting the Tax Exclusion for Employment-Based Health Insurance

Presentation at the Fifth Biennial Conference
of the American Society of Health Economists

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About This Presentation

The estimates in this presentation are preliminary and are being circulated to stimulate discussion and critical comment as developmental work for analysis of interest to Members of the Congress.

The underlying analysis was conducted by Allison Percy, Alexandra Minicozzi, and Jessica Banthin of the Congressional Budget Office and Pamela Moomau of the staff of the Joint Committee on Taxation.

That research embodies work undertaken for the staff of the Joint Committee on Taxation, but as members of both parties and both houses of Congress compose the Joint Committee on Taxation, this work should not be construed to represent the position of any member of the Committee.

About This Presentation (Continued)

The results in this presentation expand on those published in Congressional Budget Office, *Options for Reducing the Deficit: 2014 to 2023* (November 2013), www.cbo.gov/budget-options/2013/44903, using the most recent CBO baseline.

For health insurance coverage estimates under that baseline, see Congressional Budget Office, *Updated Estimates of the Effects of the Coverage Provisions of the Affordable Care Act* (April 2014), www.cbo.gov/publication/45231.

For more information about CBO's HISIM microsimulation model, see Jessica Banthin, Deputy Assistant Director, Congressional Budget Office, "Microsimulation of Demand for Health Insurance: A Method Based on Elasticities" (presentation to the AcademyHealth Annual Research Meetings, San Diego, CA, June 9, 2014), <http://www.cbo.gov/publication/45427>.

Tax Exclusion for Employment-Based Health Insurance

- Premiums paid by employers for health insurance are excluded from employees' taxable wage income and are thus exempt from federal income and payroll taxes.
- Most employees can also pay their share of premiums with pretax earnings.
- Self-employed people can deduct their health insurance premiums from their federal income taxes (but not from their self-employment payroll taxes).

Effects of the Tax Exclusion

- Reduces the cost of health insurance for employees whose employers offer such coverage
- Reduces the cost of employment-based coverage relative to nongroup insurance (holding benefits constant)
- Encourages workers to take up coverage
- Encourages employment-based coverage, which pools risks and spreads out fixed costs

Effects of the Tax Exclusion (Continued)

- Encourages choice of more generous insurance plans
- Spurs health care cost growth
- Reduces tax revenues
- Subsidizes high-income groups more than low-income groups

How Big is the Tax Subsidy and How Does It Vary by Income?

- Income tax
 - Marginal federal income tax rates rise with income
- Payroll tax
 - Includes both employers' and employees' shares of Social Security and Medicare taxes
 - The amount of income subject to Social Security taxes is capped, so rates fall with income
- Average marginal tax rates for federal income and payroll taxes combined range from 8% for incomes less than \$10,000 to 45% for incomes greater than \$1 million per year
- Most states also impose income taxes that exclude the value of employment-based health insurance premiums

Source: Joint Committee on Taxation.

Coverage Effects of Limiting the Tax Exclusion for Employment-Based Health Insurance, 2008

(Millions of nonelderly people covered)

	Pre-Policy Levels	Completely Eliminate Income and Payroll Tax Exclusion	Eliminate Income Tax Exclusion Only	Cap Tax Exclusion for Income and Payroll Tax at Median Premium
Employment-based coverage	154	-15	-10	-2
Nongroup / public	37	+4	+2	n.a.
Uninsured	49	+11	+8	+1

Source: Jonathan Gruber.

Note: n.a. = not available.

Why Would Effect Be Different Today?

- Limited alternatives to employment-based coverage before 2014
 - Public coverage
 - Many low income adults did not qualify for Medicaid
 - Few other public insurance options were available for most people
 - Nongroup coverage
 - Very few subsidies or tax preferences available unless self-employed
 - Difficult to access or afford for those with pre-existing conditions
- The Affordable Care Act (ACA)
 - New coverage options
 - New rules governing nongroup and employment-based coverage

Coverage Provisions of the Affordable Care Act

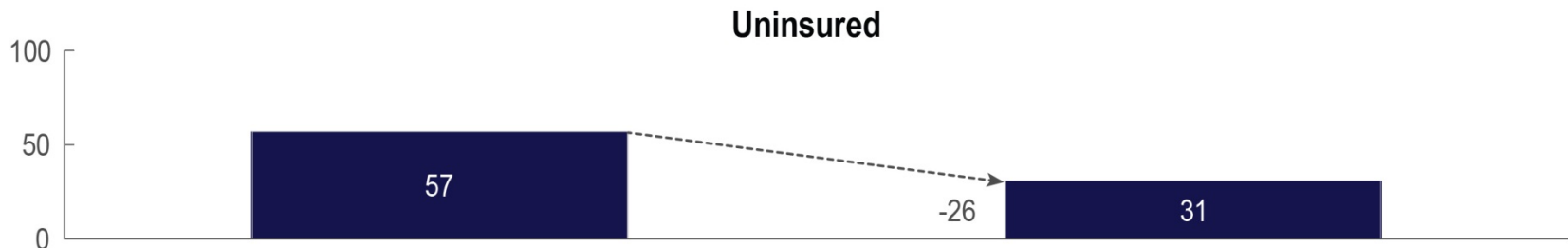
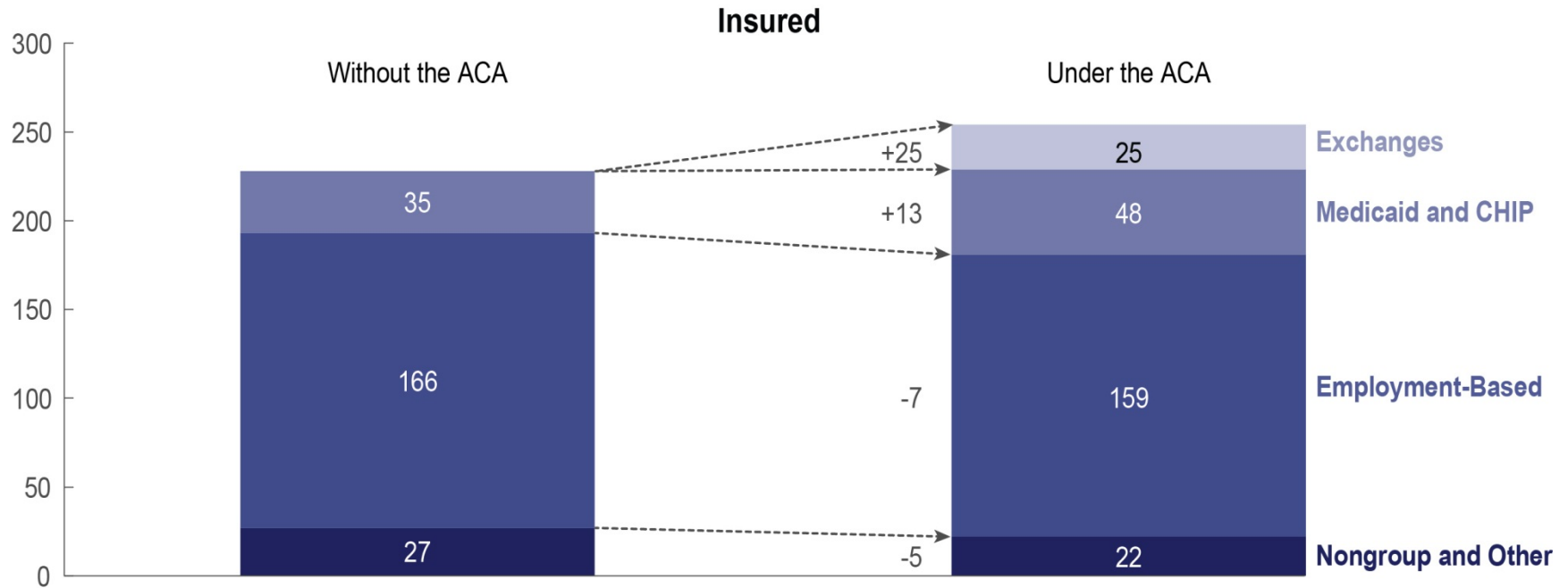
- Many individuals and families between 100 and 400 percent of the federal poverty line are able to purchase subsidized insurance through exchanges (or marketplaces).
- Insurers may not deny coverage to people on the basis of their health status or charge enrollees in poor health higher insurance premiums.
- States are permitted to significantly expand eligibility for Medicaid but may decline to do so.
- Most legal residents of the United States must either obtain health insurance or pay a penalty.

Coverage Provisions of the Affordable Care Act (Continued)

- Most employers with more than 50 full-time employees that decline to offer minimum health insurance coverage to their employees will be assessed penalties.
- A federal excise tax will be imposed on some health insurance plans with high premiums starting in 2018.
- Health insurance rules are changed in other ways

Projected Health Insurance Coverage in the U.S., 2024

(Millions of nonelderly people)



How CBO and JCT Model Health Insurance Coverage

- CBO and JCT estimate health insurance coverage effects of proposals, such as the ACA and proposed changes to the tax exclusion, using a microsimulation model (HISIM) and other models.
- HISIM is based on individual and family information from the Survey of Income and Program Participation (SIPP).
- HISIM calculates changes in the price of health insurance and uses a price elasticity of demand for health insurance to measure change in take-up of different types of coverage.

How CBO and JCT Model Health Insurance Coverage (Continued)

- $\text{Coverage}_{t+1} = f(\text{Coverage}_t, \% \Delta \text{ Price} * \text{Elasticity}, X)$
 - X = health status, income, family status, etc.
 - Equations for each possible status change, including addition or subtraction of new options
 - Availability of options depends on eligibility (for public programs) and offer status (for employment-based plans)

How CBO and JCT Model Firms' Offers of Employment-Based Coverage

- $\Delta pr(\text{offer}_i) = \varepsilon_f * \% \Delta p_i$
 - f is the size of firm i
 - ε_f is the elasticity of the change in probability of a firm offering, Δpr , with respect to a percent change in price, $\% \Delta p_i$
- Separable and additive probabilities of changing offer status based on various after-tax prices
 - Changes in the price of employment-based coverage
 - Changes in the price of alternative sources of coverage (nongroup, Medicaid, exchange plans) available to firm's employees
- Incorporates any available subsidies and the perceived substitutability of alternative coverage types

Illustrative Policies to Limit the Tax Exclusion

- Totally eliminate the tax exclusion for federal income tax and payroll tax purposes
- Eliminate the tax exclusion for federal income tax but not for payroll tax purposes
- Cap income and payroll tax exclusions at the median premium for employment-based plans

Comparing Estimates of the Coverage Effects of Eliminating the Income and Payroll Tax Exclusion

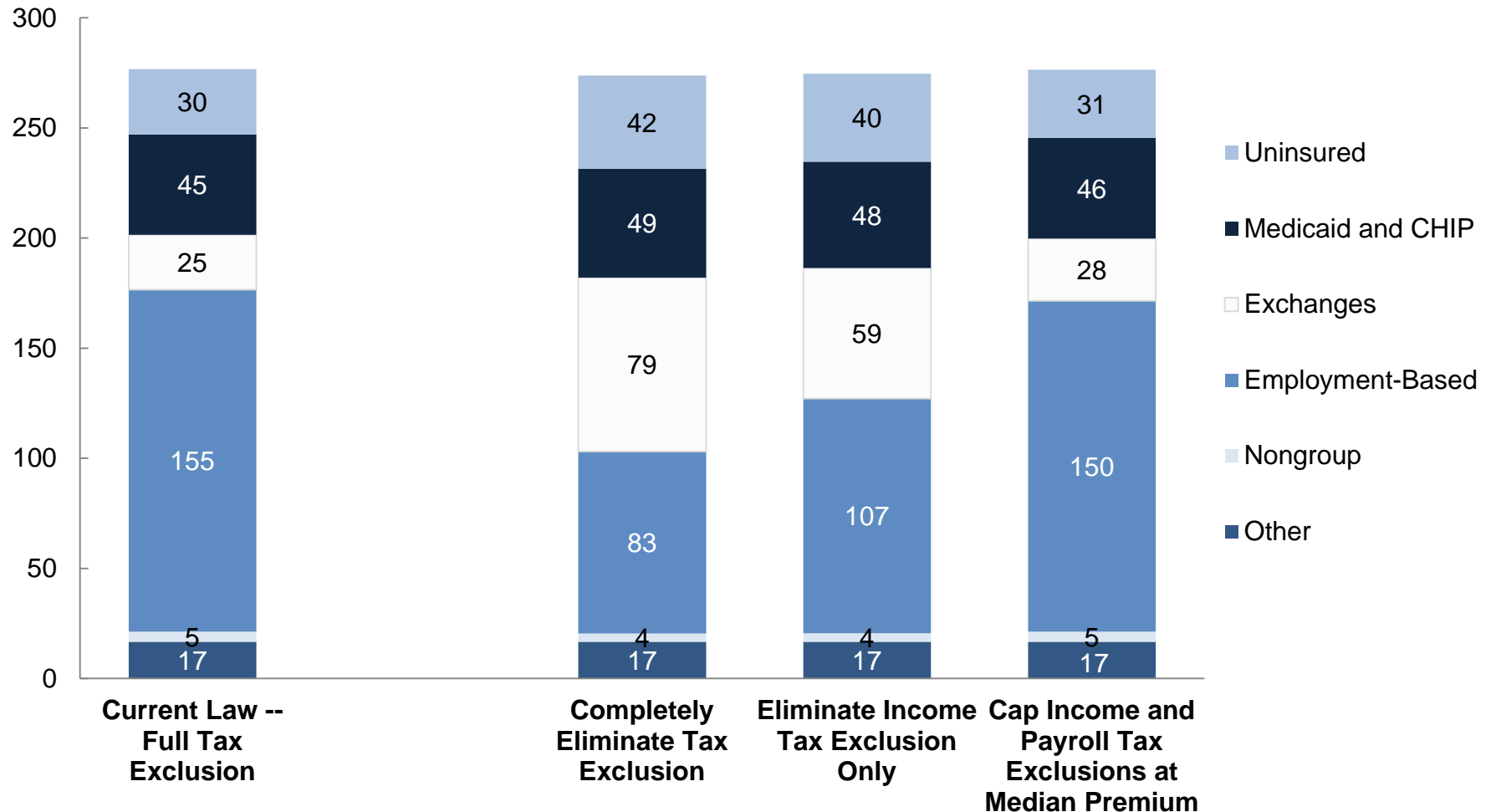
(Change in percentage of nonelderly population covered)

	Gruber	CBO/JCT	CBO/JCT
	Pre-ACA	Pre-ACA	Under the ACA
Employment-based coverage	-6%	-9%	-26%
Nongroup / public	+2%	+4%	+21%
Uninsured	+5%	+5%	+5%

Source: Jonathan Gruber, Congressional Budget Office, and staff of the Joint Committee on Taxation.

Three Approaches to Limiting the Tax Exclusion: Change in Health Insurance Coverage Under the ACA in 2017

(Millions of nonelderly people)



Three Approaches to Limiting the Tax Exclusion: Change in Health Insurance Coverage Under the ACA in 2017

(Millions of nonelderly people covered)

	Current Law Levels with Full Tax Exclusion	Completely Eliminate Tax Exclusion	Eliminate Income Tax Exclusion Only	Cap Income and Payroll Tax Exclusions at Median Premium
Exchanges	25	+54	+34	+3
Medicaid and CHIP	45	+4	+3	0
Employment-based coverage	155	-73	-49	-5
Nongroup	5	-1	-1	*
Other	17	*	*	*
Uninsured	30	+12	+10	+1

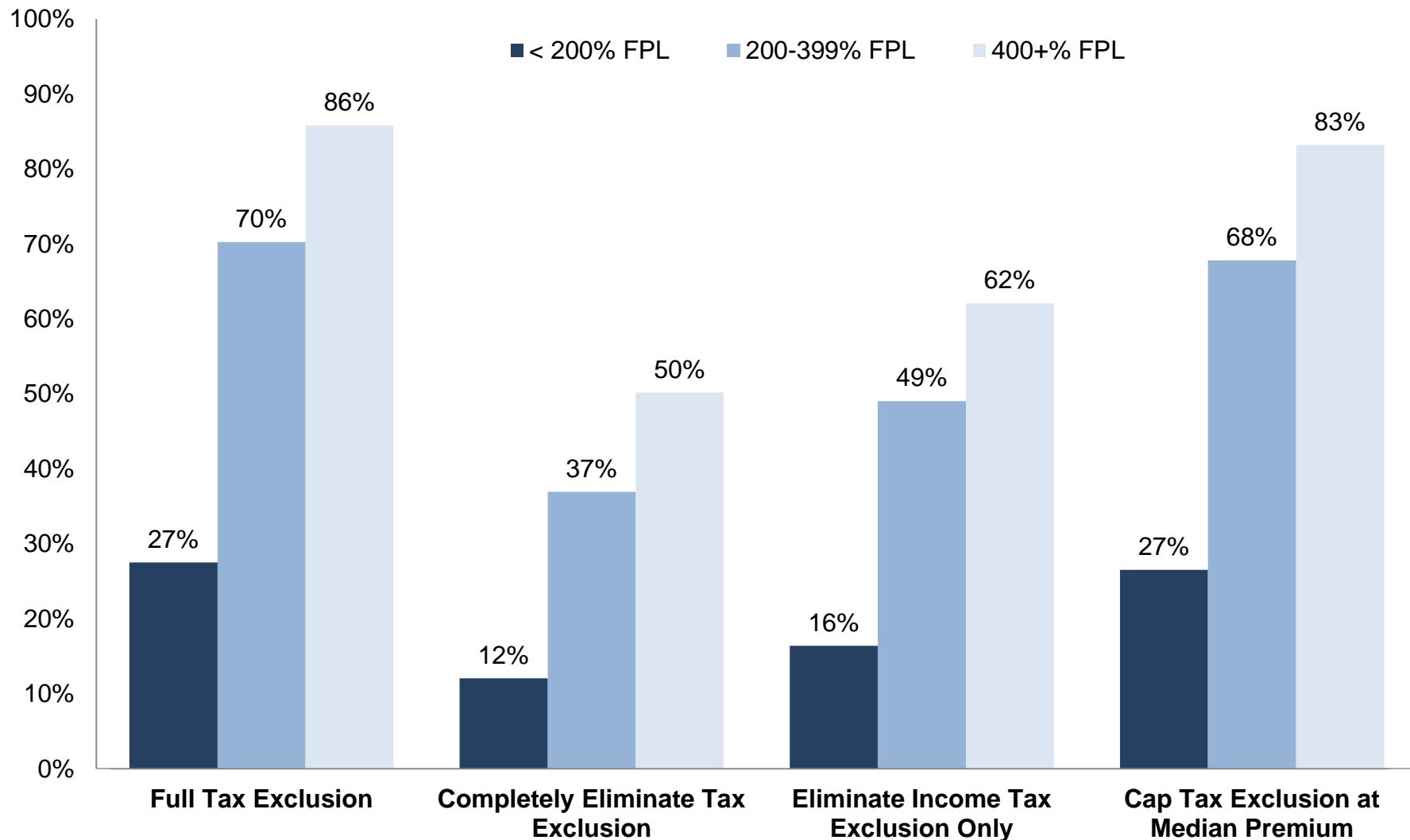
Source: Congressional Budget Office and staff of the Joint Committee on Taxation.

Note: * = between -0.5 million and +0.5 million

Three Approaches to Limiting the Tax Exclusion: Percentage of People Without Insurance in 2017, by Income Group



Three Approaches to Limiting the Tax Exclusion: Percentage of People with Employment-Based Coverage in 2017, by Income Group



Sources

Slide 5: Joint Committee on Taxation, *Overview of the Federal Tax System As In Effect for 2014* (March 28, 2014), <http://go.usa.gov/9qNT>.

Slide 6: Jonathan Gruber, “The Tax Exclusion for Employer-Sponsored Health Insurance,” *National Tax Journal* (June 2011), Tables 2 and 5; Jonathan Gruber, *The Tax Exclusion for Employer-Sponsored Health Insurance*, Working Paper 15766 (National Bureau of Economic Research February 2010), Table 4; and Jonathan Gruber, personal communication (June 17, 2014).

Slide 10: Congressional Budget Office, *Updated Estimates of the Effects of the Insurance Coverage Provisions of the Affordable Care Act*, April 2014, www.cbo.gov/publication/45231.