



The Importance of the Current Tax Treatment of Employer-Sponsored Health Coverage for Employees

Statement of
The National Business Group on Health

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The National Business Group on Health (Business Group) commends the Senate Finance Committee for its ongoing series of hearings on health reform, including its recent Health Reform Summit, and appreciates the opportunity to submit written testimony on the importance of the current tax treatment of employer-sponsored health coverage to employees, employers, and to our country as it seeks more affordable, effective and efficient health care.

Founded in 1974, the Business Group is a member organization representing 300 members, mostly large employers, who provide coverage to more than 55 million U.S. employees, retirees and their families and is the nation's only non-profit organization devoted exclusively to finding innovative and forward-thinking solutions to large employers' most important health care and related benefits issues. Business Group members are primarily Fortune 500 companies and large public sector employers, with 63 members in the Fortune 100.

With escalating health costs, increasing awareness of quality and safety gaps and growing numbers of uninsured, the need for health care reform is at an all-time high. Successful health reform, however, is a daunting but critical challenge that will require everyone—individuals, health care providers, suppliers, insurers, employers and governments at all levels to share responsibility and do their part.

As you know, today, employers are the principal source of health coverage for non-elderly people in the United States, voluntarily providing health benefits to about 161 million Americans.¹ In other words, the most recent data show that more than 60 percent of the population under age 65 is currently covered by employment-based plans.²

Employers provide health coverage for active employees, their dependents and retirees on a voluntary basis either directly by setting up self-insured employer plans or by purchasing coverage through insurance companies. The decision to provide health coverage, the level and scope of benefits, and the amount of money that employers contribute to their employees' health care depend on a number of factors including employee health and productivity improvement; the needs and preferences of employers' workforces; as a recruiting tool to attract and retain the best talent; labor market conditions; economic conditions; company growth and profitability; the relative cost of health and other benefits; and the tax advantages, which play a very important role.

Under current tax rules, employers can deduct their contributions for employees' health care from corporate income just as they deduct employees' wages and salaries as ordinary business expenses. Simultaneously, employees can exclude the value of these contributions from their income for tax purposes. They can also use pre-tax dollars to pay for their share of health premiums and often use pre-tax

¹ Fronstein, Paul and Dallas Salisbury. Health Insurance and Taxes: Can Changing the Tax Treatment of Health Insurance Fix Our Health Care System? EBRI. September 2007.

² Ibid.

dollars for their out-of-pocket health expenses through flexible spending accounts (FSAs) offered by their employers.

The Federal government has consciously used tax policy for a long time to promote health coverage and the Business Group believes that the current favorable tax treatment of employer-sponsored coverage is a key reason that so many families have affordable coverage. This policy helps employers provide more comprehensive health benefits at a lower cost to employees and their dependents.

This testimony will highlight the key role of the current tax policy and employer-sponsored health coverage in assuring coverage for so many Americans and improving the effectiveness and efficiency of health care.

This written testimony covers four main points:

- 1. The importance of the tax exclusion and employer-sponsored coverage to employees.**
- 2. The importance of the current tax treatment for employers.**
- 3. The important role and contribution of employer-sponsored health plans.**
- 4. The role of the tax treatment of employer-sponsored coverage's impact on the number of uninsured.**

1. THE IMPORTANCE OF THE TAX EXCLUSION AND EMPLOYER-SPONSORED COVERAGE TO EMPLOYEES

- Tax Advantages Help Make Health Care More Affordable for Employees**

Employees pay less for more comprehensive benefits through employer-sponsored coverage. The lower price encourages more employees to take up coverage for themselves and their families. For some employees, the tax advantages make the difference between taking up their employers' coverage and declining coverage because it is too expensive. Younger, healthier employees elect to participate in employer-sponsored coverage because the personal tax exemption for benefits, along with their employers' tax-deductible contribution, makes the coverage more affordable. Many are at the lower income levels when just beginning their families and careers; their first priority is typically net pay. These employees frequently do not have an immediate expectation of requiring health care and in fact may only occasionally utilize the coverage. They participate primarily because health care benefits are so heavily subsidized by employers and there are no adverse personal tax consequences.

- Employees Value Employer-Sponsored Coverage**

Employees and job candidates expect and value health benefits as a key part of their employment and compensation. Seventy-five percent of employees in a survey commissioned by the National Business Group on Health considered their employment-based health plan their most important benefit and 83 percent said they would rather see their salary or retirement benefit reduced over their health benefit. About three out of four employees (75 percent) who responded to the survey said they would prefer to continue obtaining health benefits through their employer rather than receiving additional salary to purchase benefits on their own³ (a copy of the survey is attached).

³ Greenwald, Matthew and Associates. National Business Group on Health Employer-Based Health Benefits Survey. April 2007.

Other surveys have similarly found that employees highly value health coverage through their employers. A recent Kaiser Family Foundation Health Tracking Poll found that when people who are currently covered through their employers were asked for their initial reactions to buying health insurance on their own, 63 percent said it would be harder to find a plan that matches their needs as well; 64 percent said they would find it harder to handle administrative issues such as filing a claim or signing up for a policy; 80 percent said they would find it harder to keep health insurance if they were sick and 81 percent said they would find it harder to get a good price for health insurance.⁴

- **A Majority of Employees Oppose Taxing Employer Health Care Contributions**

A statistically valid survey conducted last year by Matthew Greenwald & Associates for the Business Group of over 1,600 employees with employer-sponsored coverage found that **the majority of the employees, 57 percent, oppose treating employers' contributions to health plan premiums as taxable income, while only 30 percent favored this change.**⁵

2. THE IMPORTANCE OF THE CURRENT TAX TREATMENT FOR EMPLOYERS

- **Current Tax Advantages Encourage Employers to Offer Coverage**

The tax-favored status of employer-sponsored coverage encourages more employers to offer health benefits because it lowers their costs. While the percentage of employees with employment-based coverage has fallen 8 percent since 2001, primarily because of escalating costs, an average of 60 percent of employees still had employer-sponsored coverage in 2007.⁶ The tax advantages help to offset part of the costs.

- **Current Tax Advantages Encourage Employers to Offer More Comprehensive Coverage**

In many cases, employment-based coverage provides a broader scope of benefits and more comprehensive coverage than is available or affordable with individually-purchased insurance.⁷ The current tax status of employer-sponsored coverage encourages employers to offer more comprehensive benefits for employees. Examples of employer investments in health benefit programs include health coach availability to both healthy and unhealthy employees; health risk assessments; health promotion educational campaigns; richer preventive care; enhanced wellness programs; innovative disease management programs; no-cost, on-site health screenings; and provider health plan scorecards.⁸

⁴ Kaiser Family Foundation. Kaiser Health Tracking Poll: Election 2008. Conducted June 3-8, 2008. Available at: http://www.kff.org/pullingittogether/062608_altman.cfm

⁵ Greenwald, Matthew and Associates. National Business Group on Health Employer-Based Health Benefits Survey. April 2007.

⁶ Kaiser Family Foundation. Kaiser/HRET Survey of Employer-Sponsored Health Benefits. 2007.

⁷ Agency for Healthcare Research and Quality. Employer-Sponsored Health Insurance. Trends in Cost and Access. September 2004.

⁸ Fronstein, Paul and Dallas Salisbury. Health Insurance and Taxes: Can Changing the Tax Treatment of Health Insurance Fix Our Health Care System? EBRI. September 2007.

- **Current Tax Advantages Help Employers Pass Cost Savings on to Employees Through Lower Cost Sharing and Premiums/Premium Equivalents**

The favorable tax status of employer-sponsored health benefits makes it easier for employers to keep employees' costs lower—in all aspects of coverage (i.e., premiums/premium equivalents, deductibles and co-payments, coinsurance, prescription drug, cost-sharing, maximum out-of-pocket expenses, etc.). Employers pay the bulk of the costs for employees' health benefits, which are heavily subsidized. On average, employers paid 84 percent of employees' coverage costs and 72 percent of family coverage in 2007.⁹ Some employers pay 100 percent of the employee and family premiums to ensure that every employee has access to health coverage. Others lower employees' costs if they choose high-performing health plans and still others eliminate cost-sharing when employees choose in-network health care providers.

3. THE IMPORTANT ROLE AND CONTRIBUTION OF EMPLOYER-SPONSORED HEALTH PLANS

- **Employers Increase Coverage By Keeping It Affordable for Employees**

Many people with employment-based coverage are covered under highly subsidized employer plans, which are less expensive for employees. As stated earlier, on average employers pay about 84 percent of the cost for the average single coverage plan (over \$4,000 per year) and 72 percent of the cost for the average family plan (over \$12,000 per year)¹⁰ to ensure that their employees have affordable coverage. The full price is simply too high for low-income employees and even people with higher incomes without substantial employer subsidization.

- **Employer Plans' Natural Risk Pools Provide Advantages for Coverage**

Employment-based health coverage is also successful at spreading risk between the healthy and the unhealthy and between younger and older people. Pooling together risk under employer-sponsored coverage ensures that higher-risk, older or unhealthy individuals are not singled out and that the same level of coverage is provided for all plan members at similar costs. Employer plans' natural risk pools also reduce adverse selection by providing coverage automatically upon employment, requiring new employees to opt out only if they have alternative coverage or by giving new employees a short time period to enroll (typically 1 month by statute) before they become ineligible. These mechanisms reduce adverse selection because people make coverage decisions independent of their need or expected need for health care.

⁹ Kaiser Family Foundation. Kaiser/HRET Survey of Employer-Sponsored Health Benefits, 1999-2007.

¹⁰ Claxton, Gary. Et. al. Employer Health Benefits 2007 Annual Survey. Kaiser Family Foundation. 2007: Kaiser Family Foundation. Kaiser/HRET Survey of Employer-Sponsored Health Benefits, 1999-2007.

- **Employers Leverage Their Negotiating Power to Strike Better Deals for Employees' Health Care**

Because employer plans bring groups of people to health plans, in some geographic areas they are a dominant source of payment, they use their negotiating leverage with providers and insurers by bargaining for group discounts for employees, arranging prompt pay discounts with providers, serving as advocates for employees in coverage disputes, requiring quality improvements and obtaining more value for their employees' money than employees could do on their own. For example, insurers are more likely to respond to employers' requests to improve their offerings than to requests from individual plan enrollees who are unsatisfied with their current coverage because of the risk of losing a large group contract.¹¹

- **Employers Continue to Be a Source of Health Care Innovation**

Employers believe that there is a strong business case for offering health benefits to employees and they continue to invest in improving their health programs. Many large employer members of the Business Group are already using their market power to demand greater health care efficiency and quality from providers in addition to launching their own efforts to improve employees' productivity and health status. Some examples of employer initiatives include promoting quality assessment of providers; health risk assessments; offering health promotion and disease prevention programs; using care coordination; utilizing disease management and wellness programs; improving the use of primary and preventive care; and promoting the patient-centered medical home.

- **Employers' Economies of Scale Lower Administrative Costs for Employees' Coverage**

Employer-sponsored health benefits create significant administrative efficiencies, that keep more employers' and employees' dollars available to pay for medical costs. Lower administrative costs help keep employees' premium equivalents lower and enable employers to offer more benefits. Overhead costs for the largest employer groups are typically 5 percent or less, whereas these costs reach around 20 percent for smaller groups and goes above 30 percent for purchasers of individual insurance.¹² Savings of this magnitude allow employers to provide more extensive coverage for employees that otherwise would not be made available.

4. THE ROLE OF THE TAX TREATMENT OF EMPLOYER-SPONSORED COVERAGE'S IMPACT ON THE NUMBER OF UNINSURED

Many families would simply find health coverage unaffordable if they were taxed on their employers' portion of their health care costs and/or they were unable to use pre-tax dollars to pay their premiums and out-of-pocket expenses under employer-sponsored plans. In particular, younger and healthier employees could opt out of their employer coverage. The current tax advantages of employer-sponsored coverage is a

¹¹ Fronstein, Paul and Dallas Salisbury. Health Insurance and Taxes: Can Changing the Tax Treatment of Health Insurance Fix Our Health Care System? EBRI. September 2007.

¹² Hall, Mark. The Geography of Health Insurance Regulation: A Guide to Identifying, Exploiting, and Policing Market Boundaries, 19, Health Affairs. Mar.-Apr. 2000.

major factor that makes it significantly more attractive for younger people to purchase coverage through their employers. Removing the ability of employees to pay their premiums with pre-tax payroll deducted earnings and/or imposing a tax burden on them for their employers' contribution toward their health care plan costs would result in a significant number of employees simply discontinuing their coverage, causing a increase in anti-selection in employers' plans, a decrease in their ability to cross-subsidize, and subsequent cutbacks in health care benefits offered. Some employers might also choose to stop offering health care benefits in light of the resultant escalation in costs, decrease in morale among their employee population, etc.

Studies by the Urban Institute-Brookings Tax Policy Center and the National Bureau of Economic Research (NBER) estimated that eliminating the tax exclusion of employer health care contributions from income and payroll taxes would reduce employer health benefit offerings by 17 to 30 percent, and would decrease employer premium shares for those who continue to offer coverage by 30 to 42 percent.¹³ The study by the NBER also found that smaller employers would be more likely to stop offering coverage if the tax exclusion were eliminated and larger employers would be more likely to cut back on the amount they subsidize, both of which would increase the number of the uninsured substantially.

The favorable tax status of employer-sponsored coverage plays an important role in keeping employer risk pools intact so they are able to cover people of every age group and health status. Depending on the industry and labor market conditions, some employers who continue to offer health care at the same level could see increased labor costs as they are pressured to compensate employees for their higher tax payments. Finally, if health benefits were taxed, benefits such as pensions and other nontaxable benefits could be taxed in the future, which would make them more costly for employers and employees and they could potentially be eliminated or reduced.

CONCLUSION

Rather than changing the tax status of employer-sponsored coverage, which provides health care benefits to the vast majority of non-elderly Americans, the Federal government should step up efforts to use its leverage as the largest purchaser of health care and work with employers, providers and health plans to provide solutions to the rising costs and the poor and uneven quality of health care. CMS' recent initiative to stop hospital payments for "never events" to improve the quality of care in the Medicare program is an example of the type of initiative and leadership that will go further to improve the effectiveness, efficiency, and affordability of health care rather than changing the tax code.

Mr. Chairman, thank you and the Committee for this opportunity to share the National Business Group on Health's perspective on this important issue. Changing the tax status of employer-sponsored coverage would only increase health care costs for 161 million employees and their families. The vast majority of employees in employer plans, 57 percent, are opposed to being taxed on their employers' contributions to their health care coverage. The Business Group looks forward to working with the Congress to preserve

¹³ Burman, Leanord. Et al. Tax Incentives for Health Insurance. Discussion Paper 12. The Urban-Brookings Tax Policy Center. May 2003.: Gruber, Jonathan, and Michael Lettau. How Elastic Is the Firm's Demand for Health Insurance? NBER Working Paper 8021. National Bureau of Economic Research. 2000.

and protect this important benefit to ensure that employers can continue to provide the health care benefits that Americans want, need and deserve.