Washington Update

More About Repeal & Replace

February 24, 2017

On Feb. 10, 2017, Rep. Tom Price (R-GA) was confirmed as Secretary of Health and Human Services (HHS), which oversees the implementation of the Affordable Care Act (ACA). Secretary Price previously served as chairman of the House Budget Committee and has proposed a series of substitutes for the ACA subsidies and Cadillac tax. If it's left up to Price, we have a clear direction of how the replacement efforts will unfold – and it's not all roses for employers. Although Price won't have the authority to push through legislation as HHS secretary, he will have tremendous influence over the shaping of the Republican's future proposals and the replacement's implementation.

How to Pay the Bills

The issue is how to pay for subsidies or tax credits provided to low-income Americans under the ACA. The Cadillac tax was intended to be one source of revenue for the ACA, but there's bipartisan support for repealing the Cadillac tax, for a number of reasons. We'll likely see its repeal through either a stand-alone bill or as part of the overall repeal efforts submitted through the reconciliation process. Eliminating the Cadillac tax would cut estimated revenues by $87 billion through 2025. There's a technical issue with how the Congressional Budget Office (CBO) has scored this revenue amount, but I'll reserve that discussion for a later time. Just know that lawmakers will be searching for ways to replace this revenue source.

Price approached the revenue issue by capping the tax exclusion for employer-sponsored coverage in his most recent dismantling of the ACA, called the Empowering Patients First Act. To provide context, a tax exemption, exclusion or deduction from gross income is considered lost revenue for the government and is therefore referred to as a "tax expenditure." The employer-sponsored insurance (ESI) tax exclusion results in lost revenue for the federal government to the tune of an estimated $260 billion annually, making it the single largest tax expenditure in the individual federal income tax code.[1] The ESI tax expenditure includes the exclusion from an employee's income of employer-paid premiums for health insurance (or health benefits when paid directly by the employer) and long-term-care insurance premiums. Employees are also able to exclude from income contributions made through a cafeteria plan. The ESI exclusion includes the effect of these exclusions on payroll taxes but does not include the employer's deduction for premium costs as an ordinary business expense.

ESI Exclusion Pros and Cons

The main argument for continuing the ESI exclusion is to not disrupt the segment of the insurance market that's working effectively. ESI is the leading source of coverage for non-elderly people in our country. Roughly 150 million Americans[2] (two-thirds of the U.S. population under age 65) receive health insurance benefits through their employer. This compares to roughly 15.6 million people who have major medical coverage in the non-group insurance market, both inside and outside of the exchange.[3] Many believe that a complete repeal of the ESI exclusion will lead to employers choosing to not offer coverage, pushing those employees into the non-group market that's generally characterized by instability and rapidly rising premium rates. A cap on the tax benefit may also reduce the number of relatively healthy employees who obtain health insurance, thereby creating an issue of adverse selection in the employer risk pool. *(OVER)*

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[1] Congressional Budget Office. "The Distribution of Major Tax Expenditures in the Individual Income Tax System." https://www.cbo.gov/sites/default/files/113th-congress-2013-2014/reports/TaxExpenditures_One-Column.pdf.

[2] The Kaiser Family Foundation 2016 Employer Health Benefits Survey. http://kff.org/report-section/ehbs-2016-summary-of-findings/.

[3] Kaiser Family Foundation referring to recently submitted 2014 filings by insurers to state insurance departments (using data compiled by Mark Farrah Associates) for coverage as of Dec. 31, 2014.

The CBO estimates that the removal of the ESI exclusion will reduce the number of people with ESI by 15 million, or about 10 percent, and many of those who lose coverage will likely remain uninsured.

Those in favor of capping or repealing the ESI exclusion look to its regressive nature, the incentive it provides to purchase richer health insurance coverage and the need for a source of revenue. Compared to other Republican cap proposals, Price's proposal is one of the more aggressive caps with a limit on the tax exclusion for employer contributions to ESI (including employer contributions to a health savings account) of $8,000 for self-only coverage and $20,000 for family coverage. Employees would be required to pay taxes on employer contributions above this cap, so there would be a direct impact on employees' income.

The Bottom Line

Let's compare this to the Cadillac tax at a high level. In contrast to the cap on the ESI exclusion, the Cadillac tax would be levied on insurance companies and plan administrators, which would likely translate to higher premium costs that may partially be absorbed by employers. The employer's ability to deduct the premiums paid for health insurance coverage as an ordinary and necessary business expense would not be affected. Employees would absorb the tax either through higher premiums or through likely changes to their health benefits in the form of increased cost-sharing or reduced coverage. Aside from these issues, there are many studies highlighting other problems with the Cadillac tax.

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