JOINT ECONOMIC COMMITTEE

Senator Sam Brownback, Ranking Republican

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The Tax Man Cometh – Taxing Health Insurance Plans

And Raising Income and Payroll Taxes by Limiting Flexible Spending Contributions

Under the Senate Finance Committee's modified chairman's mark, beginning in 2013, all plans (with a few exceptions) that cost more than $8,000 for individuals and $21,000 for families would be subject to the high cost plans tax of 40%. Although the tax would be imposed on insurance providers and employers, the burden would be passed on to consumers.

The threshold levels for the high cost plans tax are indexed for general inflation (the CPI-U) plus one percent, which is significantly lower than the growth in health insurance premiums.[1] As a result, "threshold creep" will occur and, unless the historical trend in premium inflation is reversed, all plans will eventually fall under the tax (due to the minimum benefit requirements, plans will reach a point where they can no longer cut costs to stay below the "high cost" threshold).

How High is the High Cost Plans Tax Rate?

While 40% sounds like – and is – a high tax rate, the stated rate belies the true effective tax rate. If companies seek to maintain absolute profit levels by increasing premiums, the high cost tax of 40% will not only add $1,600 to the cost of a $25,000 plan, but the added $1,600 to the cost of the plan will then be subject to the high cost tax, which will add another $640 to the plan's cost. This cycle of tax increases followed by premium increases will result in a total increase of $2,667 to a $25,000 plan. Under this scenario, the result is that the stated tax rate of 40% would translate into an effective tax rate of 67%.

New Limits on FSA's Translate to Higher Taxes

In addition to adding new taxes to the cost of health insurance premiums, the Senate Finance Committee's modified mark would place a $2,500 cap on FSA plans, beginning in 2011.[2] The FSA cap would not be indexed, so the value would quickly diminish over time. Within just the first ten years, the value of a $2,500 contribution would fall to less than $1,700, meaning a greater percentage of families' out-of-pocket costs would be subject to taxation.[3] And for individuals who currently contribute more than $2,500, the cap would translate to an immediate tax increase. For a family with taxable income of $66,000 that had contributed $5,000 to a

[1] According to the Kaiser Family Foundation, the average growth in insurance premiums between 2004 and 2009 was 6.1%. Over this same period, the CPI increased by an average of 2.7%

[2] There is currently no limit on FSA contributions, though employers must establish their own limits. The limit for federal employees is currently set at $5,000.

[3] The value of FSA contributions was deflated by the average growth in the medical component of the CPI-U, which was 4.1% from 2004 to 2009.

health care FSA, the $2,500 limit would result in a federal income tax increase of $625 and a payroll tax increase of $191 – a total tax increase of $816.

When Will My Plan Be Taxed?

The table to the right illustrates how quickly various types of individual and family plans would be subject to the high cost plans tax.[4,5] Including FSA contributions in the calculation of the tax quickly accelerates the date that individual and family health plans would be subject to the tax.

The average individual plan without an FSA contribution would be subject to tax in 2025, just 12 years after the tax is enacted. Including a $2,500 FSA contribution would make the national average plan subject to the high cost plans tax in the very first year it is enacted, and even the average low-cost, High Deductible Health Plan (HDHP) would be subject to tax within nine years.

Type of Plan	Average Premium in 2009	First Year Subject to Tax: No FSA Contribution	First Year Subject to Tax: $2,500 FSA Contribution	Years Sooner Tax Applies With FSA
Individual Plans				
ALL PLANS	$4,824	2025	2013	12
HMO	$4,878	2025	2013	12
PPO	$4,922	2024	2013	11
POS	$4,835	2025	2013	12
HDHP/SO	$3,986	2034	2022	12
Family Plans				
ALL PLANS	$13,375	2023	2018	5
HMO	$13,470	2023	2018	5
PPO	$13,719	2022	2017	5
POS	$13,075	2024	2019	5
HDHP/SO	$11,083	2031	2028	3

*The high cost plans tax of 40% will begin in 2013 and will apply to plans (including FSA contributions, dental, and vision benefits) in excess of $8,000 for individuals and $21,000 for families. The thresholds will be indexed for general inflation plus one percent.

Source: Kaiser Family Foundation, BLS, JEC Republican Staff Calculations

Assumed growth rates are 3.7% for CPI-U plus one and 6.1% for premium costs

The average family plan without an FSA contribution would be subject to tax in 2023, just 10 years after the tax is enacted. Including an FSA contribution of $2,500 would make the national average family plan subject to the high cost plans tax within five years of enactment, and even the average, low-cost HDHP would be subject to tax within 15 years.

Bending the Cost Curve?

While the chairman's mark seeks to "bend the cost curve," it actually relies on medical costs growing faster than inflation plus one percent in order to do so. If the cost curve is actually bent so that medical costs grow at a rate equal to or less than inflation plus one percent, a huge source of revenue used to pay for the plan is lost. Many economists have suggested capping the benefits exclusion as a way to bend the health care cost curve. The excise tax on high cost plans is a backdoor approach to capping the benefits exclusion, but it is designed to disguise the tax from consumers by imposing it on insurers and employers.

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[4] Data on average 2009 premiums for individual and family plans come from the Kaiser Family Foundation.

[5] Plan types are: HMO, Health Maintenance Organization; PPO, Preferred Provider Organization; POS, Point of Service; and HDHP/SO, High Deductible Health Plan with a Savings Option.