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New Research from EBRI:

Study Examines Issues in Capping Tax Exclusion of Health Coverage

WASHINGTON—The nonpartisan Employee Benefit Research Institute (EBRI) today published a detailed study of the implications for employers and workers involved in capping the tax exclusion for employment-based health coverage, an issue that could come up during this year’s expected debate over overhauling the nation’s health care system.

Changing the tax treatment of employment-based health coverage has been a policy goal of both parties as far back as the 98th Congress (when Ronald Reagan was president), writes Paul Fronstin, director of the EBRI health research and education program and author of the study in the January 2009 *EBRI Issue Brief*.

He also notes that because employment-based health coverage is by far the most common source of health coverage in the United States, proposals to change the way coverage is taxed could have “far-reaching implications” for employers and workers.

The *Issue Brief*, available online at www.ebri.org, includes the following points:

- **Current tax treatment:** The amount that employers contribute toward workers’ health coverage is generally excluded, without limit, from workers’ taxable income. In addition, workers whose employers sponsor flexible spending accounts are able to pay out-of-pocket expenses with pretax dollars. Employers can also make available a premium conversion arrangement, which allows workers to pay their share of the premium for employment-based coverage with pretax dollars.
- **Tax cap recommendations:** In 2005, a presidential advisory board concluded that limiting the amount of tax-preferred health coverage could lower overall private-sector health spending. The panel recommended a cap on the amount of employment-based health coverage individuals can exclude from their income tax, as a way to reduce health spending.
- **Implementing a tax cap:** While a tax cap on health coverage sounds simple, for many employers it would be difficult to administer and results would vary by employer based on the type of health benefit plan, the size and demographics of their workforce, and even where the workers live. The change would be especially difficult for self-insured employers that do not pay insurance premiums, and would have to set the “premium equivalent” for each worker. This would not only be costly for employers, depending upon the requirements set out by law, but could also create fairness and tax issues for many affected workers.
- **Administrative costs:** For self-insured employers, calculating insurance premium costs under a tax cap could be done fairly easily using the Consolidated Omnibus Budget Reconciliation Act of 1986 (COBRA) premium equivalent. However, whether self-insured employers would be able to use the least costly method to determine the value of coverage will have to be determined by law and/or regulations.
- **The Sec. 89 experience:** Section 89 of the Tax Reform Act of 1986, which attempted to make employee benefits more standard and fair, became so controversial that it was repealed by Congress in 1989—in part because the regulations created regulatory burdens that were so complicated and costly as to be unworkable. Similarly, valuation calculations under a health coverage tax cap could become overly burdensome if the lessons from Section 89 are not heeded.

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