

Premium Tax—Ending the Sales Tax on Health Insurance That Raises Costs for Families, Small Businesses, Seniors, State Governments, and Taxpayers

Beginning in 2014, the Affordable Care Act (ACA) imposes a tax of at least \$73 billion through 2019 on families, small businesses and seniors in the form of what is essentially a new sales tax on health insurance. The tax begins at \$8 billion in 2014 and rises to \$14.3 billion in 2018. Thereafter it increases annually based on premium growth. While the tax is assessed on health plans, experts agree that it will impact consumers and employers that purchase coverage directly from a health insurance plan in the individual and employer markets as well as beneficiaries in public programs. The new tax is not assessed on self-funded ERISA plans, nonprofit insurers that meet specific criteria, and certain voluntary employee benefit associations (VEBAs).

What Is the Impact of the Tax?

While one of the goals of the ACA is to make coverage more affordable, the sales tax on health insurance will have the opposite effect by increasing costs for families, small businesses and seniors. Several experts have quantified the degree to which this tax will drive premiums higher:

- ▶ According to Doug Holtz-Eakin, former director of the Congressional Budget Office, the sales tax on health insurance alone—once one factors in the non-deductible nature of the tax—will place an upward pressure of \$135 billion on premiums over the next 10 years [through 2020]. This tax will add as much as 3 percent per year (\$475) to the average family premium, or nearly \$5,000 per family over a decade.¹
- ▶ In a May 2011 letter to Senator Jon Kyl, the Joint Committee on Taxation estimated that repealing the sales tax on health insurance would reduce the premiums of plans by 2.0 to 2.5 percent, and that eliminating this tax could decrease the average family premium in 2016 by \$350 to \$400.²
- ▶ An actuarial study conducted by the firm, Oliver Wyman, examined the premium tax impact on employers and families purchasing coverage in different segments of the commercial market. Average premiums will increase by as much as 2.8 to 3.7 percent due to the new tax—increasing the cost of small-group family coverage by about \$6,800 over a 10-year period.³



- ▶ The Oliver Wyman report also finds that the tax would create unintended consequences. First, the tax would create incentives for employers to self-fund their health benefits coverage—in order to avoid paying the tax—thereby shifting the burden of the tax on to small businesses purchasing fully-insured coverage. Second, the study concludes that the tax would likely exacerbate problems related to adverse selection in the individual and small-group markets—as younger, healthier individuals forego coverage leading a less stable risk pool and higher premiums.
- ▶ The report also assessed the tax's impact on private plans that participate in public programs and finds that the tax will likely increase costs for beneficiaries—through higher premiums and/or higher cost-sharing—enrolled in Medicare Advantage and Medicare Part D prescription drug plans. The tax will put pressure on already-strained state Medicaid budgets by increasing the costs of contracting with Medicaid managed care organizations.

Who Pays the Tax?

The scope of this new tax is broad. Employers purchasing fully insured coverage, including most small businesses, will face higher premiums due to this tax as well as individuals who purchase coverage on their own. Medicare beneficiaries enrolled in a Medicare Advantage plan or a prescription drug plan will face higher costs, as will states that include managed care organizations in their Medicaid programs. The Oliver Wyman study examines the impact of this tax:

- ▶ **Businesses that purchase insurance—including all small businesses that fully insure their workforces.** These businesses will pay a portion of the tax, which will increase premiums for employers struggling to maintain coverage for employees. Small

businesses will face additional premiums over the ten-year period (2014-2023) of \$2,760 for single coverage and \$6,830 for family coverage. Larger businesses will pay an average additional premium of \$2,610 (single coverage) and \$7,130 (family coverage) due to this tax.

- ▶ **All individuals and families who purchase coverage in the individual market or through an Exchange.** These consumers feel the brunt of the tax through higher premiums. Individuals and families will confront premiums that are \$2,150 (single coverage) and \$5,080 (family coverage) higher over ten years if this sales tax on health insurance remains in place. In addition, individuals and families cannot deduct premium payments from federal income taxes and therefore already face the challenge of purchasing coverage with after-tax income, a disparity that is particularly harmful to individuals and families who do not qualify for exchange subsidies.
- ▶ **Medicare beneficiaries who enroll in Medicare Advantage health plans.** Medicare Advantage (MA) plans will pay between \$16-\$20 per member per month in 2014 and up to \$32-\$42 per member per month in 2023 as a result of this tax. Given the average annual MA premium is roughly \$39 for beneficiaries, this represents a significant increase in MA beneficiary premiums.⁴ Medicare Advantage enrollees are already burdened with the expected impact of the ACA funding cuts: reductions in additional benefits and choices. This tax will likely exacerbate the reduction in additional benefits and access to health plans for Medicare Advantage enrollees.
 - The new tax also falls on Medicare Part D prescription drug plans causing an average increase in premiums of \$9 in 2014 and \$20 in 2023 for a total increase of \$161 over 10 years.

► **States that contract with managed care organizations under Medicaid.** Medicaid health plans are limited in their ability to establish beneficiary premiums to raise additional revenues to cover the cost of the tax. This tax is likely to increase state contracting costs under state budgets, which are already experiencing fiscal crises that jeopardize the sustainability of Medicaid programs. The average cost of Medicaid coverage will increase by an estimated \$1,530 per enrollee between 2014-2023 with a total increase in costs to Medicaid plans of over \$20 billion. Since the federal government shares in the financing of the Medicaid plans, an increase in the Medicaid costs due to the additional federally mandated tax will partially be paid through the federal share of Medicaid.

3) Third, this new tax is layered on top of existing state and federal taxes levied on health plans that have been in place prior to ACA, including state premium taxes, assessments to support high risk pools, and state and federal income taxes, among others.

Recommendation:

Repealing the tax will reduce the financial burden on families, businesses and seniors when they purchase coverage in the reformed 2014 market.

¹ Holtz-Eakin, Douglas. "Higher Costs and the Affordable Care Act: The Case of the Premium Tax." American Action Forum. 9 March 2011. <http://americanactionforum.org/sites/default/files/Case%20of%20the%20Premium%20Tax.pdf>.

² See JCT Letter to Senator Jon Kyl (May 12, 2011).

³ Carlson, Chris. "Estimated Premium Impacts of Annual Fees Assessed on Health Insurance Plans." Oliver Wyman. 31 October 2011.

⁴ Kaiser Family Foundation. Medicare Advantage Enrollment Market Update; September 2011. <http://www.kff.org/medicare/upload/8228.pdf>

The Compounding Effect of New and Old Taxes

It is important to examine the new sales tax on health insurance in the context of future and existing taxes on several health care sectors:

- 1) First, additional ACA taxes, including those on prescription drug and medical device manufacturers, will increase the unit costs of health care, which will subsequently increase premiums for individuals, families and small businesses.
- 2) Second, the effective amount of the tax on consumers well exceeds the amounts specified in the statute as the ACA constructed this tax to be non-deductible, unlike other federal, state and local taxes. This means that health plans must pay the tax and then pay federal, state and local taxes on the taxed amount.



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