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## Congress of the United States

JOINT COMMITTEE ON TAXATION  
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JUN 02 2009

Honorable Max Baucus  
Chairman  
Committee on Finance  
United States Senate  
SH-511  
Washington, DC 20510

Honorable Charles E. Grassley  
Ranking Member  
Committee on Finance  
United States Senate  
SH-135  
Washington, DC 20510

Dear Chairman Baucus and Ranking Member Grassley:

This letter and the enclosed table provide estimates of the revenue effects of several proposals to cap the income tax exclusion for employer-provided health care as well as other proposals. I provided these estimates orally at the Senate Finance Committee Meeting on May 20, 2009, on Financing Comprehensive Health Care Reform. Chairman Baucus asked that I provide all Committee members with the enclosed table.

### Health Proposals

Present law provides for exclusions from the individual income tax and from taxes under the Federal Insurance Contributions Act ("FICA") for employer contributions toward health insurance and health care for active and former (or retired) employees. Present law does not limit the amount of employer-provided health benefits that may be excludable from income and FICA taxation. These exclusions also apply to employer contributions both to health savings accounts ("HSAs") of employees, which are limited to \$3,050 for an individual and \$6,150 per family in 2010, and to employer payments for health care through health reimbursement arrangements ("HRAs"). Active employees may also receive income and FICA tax exclusions for health insurance premiums paid through a section 125 cafeteria plan via a salary reduction arrangement and for out-of-pocket health care expenses paid through flexible spending arrangements ("FSAs") which are limited only by the employer.

Also under present law, for purposes of the individual income tax, self-employed individuals who purchase their health insurance may take an above-the-line deduction for the full amount of their health insurance premiums. However, the deduction is not allowed for purposes

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of determining net earnings from self-employment, and may not exceed the amount of self-employment income.

The proposals which limit the income tax exclusion for employer-provided health care as well as the self-employed individual deduction for health insurance expenditures. In all of the proposals, the FICA exclusion remains uncapped; however, the estimates include the effects of FICA payments on increased taxable wages as a result of this reduced health coverage by employers. HSA contributions remain outside of the cap, subject to their own maximum contribution limit.

We assumed that employer contributions to health insurance that exceed the premium caps would not be deductible as a medical expense under section 213(d) for employees or for those using the self-employed health deduction. We are also assuming that all proposed premium caps would include contributions to FSAs and HRAs within their caps.

1. The first proposal would cap the income tax exclusion for employer-provided health insurance and health care at the amount of the actuarial value of the Federal Employees Health Benefit Plan (“FEHBP”) Blue Cross/Blue Shield “standard option” in 2010, and index this cap by the per capita medical cost growth index (“CMS”) for years after 2010.
2. The second proposal would impose the cap on the income tax exclusion for employer-provided health insurance and health care at the amount of the actuarial value of the FEHBP Blue Cross/Blue Shield “standard option” in 2010 only on taxpayers filing single, married filing separately, or head of household returns who have adjusted gross incomes in excess \$100,000 and taxpayers filing joint returns with adjusted gross incomes above \$200,000. These caps would be indexed by the CMS index for years after 2010.
3. This proposal would limit the income exclusion for employer-provided health care to 50 percent of the total premium amount.
4. This proposal repeals the section 213 deduction for medical expenditures over 7.5 percent of AGI.
5. This proposal eliminates the exclusion for health expenditures made through FSAs and HRAs.

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**Other Proposals**

1. The first non-health coverage related proposal imposes a Federal excise tax of 3 cents per 12 ounces of sugar-sweetened beverages. This includes carbonated and non-carbonated beverages sweetened with sugar, high fructose corn syrup or other sweeteners, but excludes juices and beverages sweetened with artificial sweeteners.
2. The second non-health related proposal increases the Federal excise tax on alcohol to \$16 per proof gallon for all alcoholic beverages including beer, wine and spirits.

**Estimating Assumptions**

We have assumed that, for the purpose of administering these proposals, the value of employer-sponsored health insurance would be determined as under the COBRA continuing health care coverage rules. That is, each employer would divide total health plan costs by the number of employees in the health plan to obtain an average cost per employee (with separate calculations for single and family coverage), and this average cost would be subject to the caps.

We have assumed that most collective bargaining arrangements will have expired after three years, but some, particularly those providing benefits for retirees, would continue throughout the budget period.

We have assumed that for the purpose of administering these proposals the caps on the income tax exclusion would also apply to any health coverage that employers provide to retirees, and that the valuation method for such coverage would be the same as for active employees. That is, each employer would divide total retiree health plan costs by the number of retirees in the health plan to obtain an average cost per retiree (with separate calculations for single and family coverage), and this average cost would be subject to the caps. Amounts in excess of the caps would be subject to income taxation.

We have assumed that an employer would be required to withhold from an employee's cash wages the income taxes that would be payable on all employer-provided health care benefits that are in excess of the caps. We have also assumed that an employer would be required to report all of its health care contributions to employees and to the Internal Revenue Service ("IRS") on IRS Form W-2.

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We project that the proposal to cap the income tax exclusion for employer-paid health insurance and health care would lead to a small decrease in premiums and health plan generosity for employer-paid health insurance, because the capping of the tax exclusion increases the marginal cost of some insurance plans to some individuals and this would be partly offset by an increase in out-of-pocket medical expenses.

As stand-alone proposals, we expect that each of these proposals would result in a reduction in the number of people receiving employer sponsored insurance, ranging from 10-12 million people losing employer coverage due to a full repeal of the exclusion to fewer than one million people losing employer coverage if the exclusion is capped only for higher income people. Of those who lose employer coverage, we project that 30 to 40 percent of them would obtain coverage in the non-group market. The revenue estimate includes the effects of increased taxable wages as a result of this reduction in the offering of health coverage by employers and in the generosity of the coverage that is offered. To the extent that these proposals were part of a broader health coverage reform initiative that included mandatory insurance coverage or other proposals that would increase incentives for coverage, the changes in employer coverage could be considerably different. The estimated revenue effects presented below include both income tax effects and induced increases in FICA payments that arise from these increases in taxable wages.

With respect to the other non-health-related proposals described above, currently there is no Federal excise tax on sweetened drinks. There is a Federal excise tax imposed on distilled spirits, wine and beer produced in, or imported into, the United States. Both the tax rates and the volumetric measures on which the taxes are imposed differ depending on the type of beverage. Taxes are lower on the alcohol content of beer and still wines than on the alcohol content of distilled spirits and naturally sparkling wines. Distilled spirits, wine, and beer produced or imported into the United States are taxed at the following rates: On a per ounce basis, distilled spirits are taxed at roughly 21 cents per ounce of alcohol, still wines at 8 cents per ounce of alcohol (assuming an average alcohol content of 11 percent), and beer at 10 cents per ounce of alcohol (assuming an average alcohol content of 4.5 percent).

These estimates assume that no other changes are made in available alternative health insurance options or in the current regulatory environment for health insurance. The estimates would change in the context of a broader proposal that affected the general health insurance market.

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I hope this information is helpful to you. If we can be of further assistance in this matter, please let me know.

Sincerely,



Thomas A. Barthold

Enclosure: Table #09-2 059

cc: Honorable John D. Rockefeller, IV, Honorable Kent Conrad, Honorable Jeff Bingaman, Honorable John F. Kerry, Honorable Blanche L. Lincoln, Honorable Ron Wyden, Honorable Charles E. Schumer, Honorable Debbie Stabenow, Honorable Maria Cantwell, Honorable Bill Nelson, Honorable Robert Menendez, Honorable Thomas Carper, Honorable Orrin G. Hatch, Honorable Olympia J. Snowe, Honorable Jon Kyl, Honorable Jim Bunning, Honorable Mike Crapo, Honorable Pat Roberts, Honorable John Ensign, Honorable Mike Enzi, and Honorable John Cornyn

- Committee on Finance -  
**ESTIMATED REVENUE EFFECTS OF CERTAIN PROPOSALS THAT RAISE REVENUE FROM THE 111TH CONGRESS**

**Fiscal Years 2010 - 2019**

*[Billions of Dollars]*

Provision	Effective	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2010-14	2010-19
<b>Health Proposals</b>													
1. Cap income exclusion at FEHBP, index to CMS..	tyba 12/31/09	20.8	31.4	34.3	37.6	41.2	44.4	47.4	50.5	53.7	57.2	165.4	418.5
2. Cap exclusion at FEHBP, for single filers with AGI in excess of \$100,000 (\$200,000 for joint returns), index to CMS.....	tyba 12/31/09	6.7	10.4	11.7	13.2	15.0	16.8	18.7	20.8	23.0	25.7	56.9	161.9
3. Limit income exclusion to 50 percent of premium amount.....	tyba 12/31/09	57.8	88.2	96.5	105.5	115.2	124.1	132.7	141.5	150.8	160.8	463.2	1,173.1
4. Repeal itemized deduction for medical expenditures above 7.5 percent of AGI.....	tyba 12/31/09	5.0	13.8	16.6	17.8	18.8	20.0	21.6	23.3	21.7	22.0	72.0	180.7
5. Repeal exclusion for health expenditures made through Flexible Savings Accounts and Health Reimbursement Accounts.....	tyba 12/31/09	3.8	5.6	5.9	6.4	6.9	7.3	7.6	7.9	8.4	8.8	28.6	68.6
<b>Other Proposals</b>													
1. Impose a Federal excise tax of three cents per 12 ounces of sugar-sweetened beverage.....	1/1/10	4.7	4.8	4.9	5.0	5.1	5.2	5.3	5.4	5.5	5.6	24.5	51.6
2. Excise tax of \$16 per proof gallon on all alcoholic beverages.....	1/1/10	4.9	5.9	6.0	6.1	6.2	6.3	6.4	6.5	6.6	6.7	29.1	61.5

Joint Committee on Taxation

NOTE: Details may not add to totals due to rounding.

Legend for "Effective" column: tyba = taxable years beginning after