



# AMERICAN BENEFITS COUNCIL

May 26, 2009

The Honorable Max Baucus  
Chairman  
Senate Finance Committee  
Washington, DC 20510

The Honorable Charles Grassley  
Ranking Member  
Senate Finance Committee  
Washington, DC 20510

Re: Comments on Senate Finance Committee Policy Options for Financing  
Comprehensive Health Care Reform

Dear Senators Baucus and Grassley:

On behalf of the American Benefits Council (the Council), I would like to thank you for your continued leadership in helping to ensure that we continue to take the necessary steps to ensure that all Americans have access to comprehensive health coverage. I would also like to thank you for the opportunity to participate in the Committee's May 12 roundtable on financing options for comprehensive health care reform, and to now comment on the Committee's recent paper discussing those options.

The Council is a trade association representing principally Fortune 500 companies and other organizations that assist employers of all sizes in providing benefits to employees. Collectively, the Council's members either sponsor directly or provide services to retirement and health plans covering more than 100 million Americans.

The following is a summary of our comments and recommendations. It is our hope that you and your fellow Committee members will give them full consideration as you move forward in the development of health care reform legislation.

- System-based cost savings should continue to be the first and foremost source of financing for health care reform.

- As Congress seeks equitable methods to finance health reform, it should be recognized that employers and employees are already paying the largest share of health care costs in this country.
- The current employer-based health system succeeds in delivering comprehensive health care to a majority of American families and thus should be a foundation for any future reforms, not dismantled or unintentionally undermined to raise revenues to support broader health care reform measures.
  - The Council supports the current income and payroll tax exclusion for employer-paid health care coverage (*i.e.*, the employee tax exclusion). Equating to less than 10 percent of our annual health expenditures, there can be little doubt that the current employee exclusion makes possible essential coverage for a significant majority of American families.
  - As our experience with now-repealed Internal Revenue Code (Code) section 89<sup>1</sup> illustrates, valuing health coverage in a tax-equitable manner is a very expensive and very difficult endeavor – requiring a host of factors to be taken into account, such as employee populations, employee age, geographic differences, and indexing.
  - Contrary to the statement contained at page 19 of the Committee’s options paper, the Council does not believe that COBRA premiums, as determined under current rules, can and/or should be used as the basis for determining an individual’s tax liability for federal tax law purposes. COBRA premiums fail to take into account a host of important factors and are likely to result in an overstatement of tax liability for many employees of large multi-state employers.
  - Recent data makes clear that HSAs, HRAs, and FSAs are utilized by many employers as an integral component of their health plan offerings and that both employers and employees are generally very satisfied with their HSA, HRA, and/or FSA plans. Accordingly, we believe that there is a strong justification for maintaining the supportive tax rules for these account-based health plans.

**System-based cost savings should continue to be the first and foremost source of financing for health care reform.**

The Council and its members were very pleased to see that the financing options discussed in your recent options paper began with a discussion of “Health System Savings”– of how we should “look within the current health care system for

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<sup>1</sup> I.R.C. § 89.

opportunities to reduce waste and inefficiencies [to] produce significant savings to finance health care reform.”<sup>2</sup>

As outlined in much more detail in my prior statement to the Committee and in the Council’s recent paper, *Condition Critical: Ten Prescriptions for Reforming Health Care Quality, Cost and Coverage*<sup>3</sup>, the Council believes that we need to look for cost savings from within the system as one important way to help finance any reform measures. Moreover, the Council and its members believe that cost savings and revenue can be achieved from within the system; though we do caution conservatism in estimating the level of savings able to be achieved from these sources.

For example, we believe that cost savings and revenue can be achieved, in part, through the following: (i) increased quality of care, *e.g.*, by implementing nationwide interoperable health information technology, and providing safe harbor protections for health care providers and payers for decisions and practices that are evidence-based; (ii) increased transparency in pricing and quality of medical care, *i.e.*, by making price and performance information more easily accessible, so consumers can identify providers with a proven record of delivering high-quality care; (iii) reform of the individual insurance market to make it more efficient by modifying current rules that foster adverse selection within the market and limit the pooling of risk for pricing and selling insurance; and (iv) reasoned reform of current medical liability rules, such as reform with respect to unwarranted attorney’s fees and excessive damages awards.

Accordingly, the Council urges the Committee to continue to focus on system-based cost savings as a principal source of financing for health care reform.

**As Congress seeks equitable methods to finance health reform, it should be recognized that employers and employees are already paying the largest share of health care costs in this country.**

As noted in my prior statement to the Committee, the Council and its members strongly believe that costs in reforming the current health system should be shared equitably by all stakeholders within the system, and that any reforms should not come at a cost to the long-term sustainability of the employer-based system – a system that has provided and continues to provide comprehensive medical coverage for a majority of American families.

The current tax treatment of employer-provided health coverage benefits workers at all income levels – and most especially benefits low and moderate income level workers – because the coverage equates to a comparatively higher share of their total income.

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<sup>2</sup> Press Release, Committee On Finance, Baucus, Grassley Release Policy Options for Financing Comprehensive Health Care Reform (May 18, 2009).

<sup>3</sup> AMERICAN BENEFITS COUNCIL, *CONDITION CRITICAL: TEN PRESCRIPTIONS FOR REFORMING HEALTH CARE QUALITY, COST AND COVERAGE 1* (2009), available at [www.americanbenefitscouncil.com/documents/condition\\_critical2009.pdf](http://www.americanbenefitscouncil.com/documents/condition_critical2009.pdf).

Moreover, the delivery of the benefits is equitable because workers at all wage and salary levels who work for the same employer are accorded the same health plan coverage.

Significantly, employers and employees already expend a significant amount of financial resources to ensure that employees and their families have health coverage. In 2007, employers as a group paid an astounding \$530+ billion for group health plan coverage for their workers and their families.<sup>4</sup> On average, this amounted to \$9,325 per employee for family coverage in 2008.<sup>5</sup> Notably, employees have also been working hard to pay their share of our nation's health care burden. In 2008, in addition to the employer premium contributions noted above, employees paid on average \$3,354 toward the premium costs associated with their employment-based health coverage.<sup>6</sup> Accordingly, to the extent that additional revenue sources are needed after taking into account those generated from system-based changes, Congress should acknowledge that employers and employees already shoulder the principal burden for financing the nation's health care costs.

**The current employer-based health system succeeds in delivering comprehensive health care to a majority of American families and thus should be a foundation for any future reforms, not dismantled or unintentionally undermined to raise revenues to support broader health care reform measures.**

In the Committee's recent options paper, there is a discussion titled "Exploring current health care tax expenditures," which includes several options for "modifying the current tax treatment of health-related expenditures to eliminate inconsistencies and discourage wasteful health care spending."<sup>7</sup> To the extent that there are inconsistencies with respect to the tax treatment of health-related expenditures and/or evidence of wasteful health care spending, the Council and its members support any reforms that are specifically tailored to address those matters. The Council and its members, however, support the current tax rules which have been one of the cornerstones in employer-sponsored health coverage serving most Americans.

The current employer-based model for health care has been, and continues to be, very successful in delivering comprehensive health coverage to a majority of American families. In fact, in 2007, 61% of non-elderly Americans were covered by employer-based health insurance.<sup>8</sup> All available data indicates that, by and large, those 160 million

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<sup>4</sup> EMPLOYEE BENEFIT RESEARCH INST., EBRI DATABOOK ON EMPLOYEE BENEFITS tbl.2.2f (2009), available at <http://www.ebri.org/pdf/publications/books/databook/DB.Chapter%2002.pdf>.

<sup>5</sup> THE KAISER FAMILY FOUND. & HEALTH RESEARCH & EDUC. TRUST, EMPLOYER HEALTH BENEFITS 2008 ANNUAL SURVEY 1ex.A (2008), available at <http://ehbs.kff.org/pdf/7790.pdf>. This amount reflects the portion of the premium paid by an employer for coverage for a family of four.

<sup>6</sup> *Id.* This amount reflects the portion of the premium paid by an employee for coverage for a family of four.

<sup>7</sup> See Press Release, Committee On Finance, *supra* note 2.

<sup>8</sup> KAISER FAMILY FOUNDATION, THE UNINSURED: A PRIMER, KEY FACTS ABOUT AMERICANS WITHOUT HEALTH INSURANCE 1 (2007), available at [www.kff.org/uninsured/upload/7451-03.pdf](http://www.kff.org/uninsured/upload/7451-03.pdf).

Americans who receive health care coverage through the employment setting are exceedingly satisfied. A 2007 study by the National Business Group on Health reported that over 67% considered their employer-provided coverage to be either “excellent” or “very good.” Moreover, there is little to no evidence indicating that the current employee tax exclusion fosters “inconsistencies” or wasteful health care spending. Thus, the Council urges the Committee to recognize the inherent value of the current employer-provided system (including the existing tax treatment) in delivering comprehensive coverage to American families. The Council believes that any reform measures should be designed to build upon the current employer-based model.

*“Caps” or limits on the employee tax exclusion raise significant implementation issues.* On pages 18 and 19 of the Committee’s options paper, several options are put forth to “limit the value of employer-provided health coverage that is excludible from gross income.” As stated in the paper:

[t]he limit could be based on the value of the plan or the income of the insured, or the limit could be a combination of both. Alternatively, the limit could be tied to a percentage of the value of the employer-provided health coverage.

Per my earlier written statement to the Committee, we believe that it would be a mistake to limit or otherwise undermine the current employee exclusion. Equating to less than 10 percent of our annual health expenditures, there can be little doubt that the employee exclusion makes possible essential coverage for a significant majority of American families. Increasing taxes on those who participate in health plans is not the way to solve the health care system’s ills. Limiting the exclusion based upon the cost of some level of coverage raises a number of issues:

- *Geographical differences in cost.* Any limit on the current employee exclusion would operate as nothing more than a tax increase for individuals who live in higher-cost areas given the very real variations in health care costs by geographic location. But even those in lower-cost areas might not be protected. For example, if an individual works for a large multi-state employer, with most of its employees in high-cost areas, such individual might be subject to tax because the insurance cost for the group as a whole is generally higher.
- *Differences in age among employees.* Any limit on the employee exclusion could penalize workers based on age. Most notably, older workers likely would be subject to a higher tax than younger workers because their coverage generally costs more. Additionally, younger workers who are employed by a company with a comparatively older, more expensive workforce likely would be taxed more than their counterparts at another company with an overall younger workforce.
- *Treatment of multi-state plans.* A limit on the employee exclusion would necessitate an extraordinarily complex set of rules to specify if, and how, multi-state employers can combine worksite employee groups for purposes of

valuing and pricing health insurance. Without such rules, workers whose employers combine their workforces from high-cost areas would be more likely to run afoul of any limit on the employee exclusion than workers whose employers combine their workforces from high- and low-cost areas for purposes of valuing and pricing health coverage. Complexity and inequity would result.

- *Indexing.* Unless any limit on the current employee exclusion is indexed using an appropriate measure that reflects real cost increases, any such limit is unlikely to keep pace with increasing health costs. The end result would be that the tax benefits delivered vis-à-vis the employee exclusion in Year 1 would be less in each subsequent year. Notably, this is, in part, how the Bush Administration's health care reform proposal was scored as revenue-neutral over 10 years – by indexing the proposed standard above-the-line deduction based on the overall Consumer Price Index (CPI), not the health component of the CPI, which is a much more reliable indicator of annual health cost increases.

Some have suggested that a “cap” on the amount of the exclusion and/or the absence of any meaningful indexing would help contain health costs. It is true that changes in the employee exclusion would likely make health care more expensive for employees and that generally when you make something more expensive people tend to use less of it. If only it were that simple when it comes to health coverage. It is hard to imagine that employers or employees need any additional incentives to try and reduce health care costs. It is unclear whether such cost containment would in fact be realized. We doubt that the nation would want to experience diminished health care coverage based on such an untested theory.

A limit on the exclusion based not upon the extent of coverage, but rather on the income of the family receiving such coverage, has its own set of complexities and inequities. It is essentially nothing more than a tax increase on individuals with income above whatever threshold is set – simply a less straightforward and explicit one. This is because the value of any employer-paid coverage would be taxable to such individuals as additional W-2 wages. One can only begin to imagine the complexities and inequities that would result from imposing a tax on families whose incomes are above the specified threshold, but whose members have differing levels of health coverage from multiple sources. Limits on the employee exclusion undoubtedly would have a destabilizing effect on the employer-sponsored health coverage system. An even more obvious and greater destabilization of the system would result if limits were imposed on employers' ability to deduct health care expenditures.

*History has shown us that valuing health care coverage in a tax equitable manner is a very expensive and very difficult endeavor.* As the above discussion is intended to demonstrate, it would be very difficult, if not impossible, to design a limit to the current employee exclusion that did not result in tax inequities and/or require a burdensome and costly set of valuation rules for employers and workers. Notably, this was tried once

before with the enactment of Code section 89 and it was famously unsuccessful. Despite best intentions, the statutory and regulatory regime established by Congress and the Treasury Department for purposes of valuing employer-provided health coverage proved completely unworkable.

One reason the valuation rules were so complex under Code section 89 is because there is great diversity among employer plans. This diversity is driven in large part by employer innovations in plan design fashioned to provide the coverage that best meets the specific coverage needs of a particular workforce. Quite apart from the cost and complexity that Code section 89 imposed on employers, had it gone into effect, it would have stifled innovation and inexorably led to coverage that was less responsive to workers' needs. Congress was left with no choice but to repeal Code section 89 just as the law was going into effect, after employers had wasted countless millions of dollars in a futile effort to comply with a set of ill-advised requirements.

***COBRA continuation premiums are ill-suited for use in valuing health coverage as part of any taxing regime.*** On page 19 of the Committee's financing options paper, it states that "the value of employer-provided health insurance coverage could be determined as the employer-provided portion of the applicable premiums currently excludible for the taxable year for the employee determined under the rules for COBRA continuation coverage." For several reasons, the Council does not believe that COBRA premiums, as determined under current rules, can and/or should be used as the basis for determining an individual's tax liability for federal tax law purposes.

COBRA premiums are not currently used as part of any taxing regime, nor are they designed for such use. COBRA premiums are designed to do one thing and one thing alone – establish an average price that applies across an employer's workforce so that any given individual who is otherwise eligible for COBRA continuation coverage may voluntarily elect such coverage under his or her employer's group health plan by payment of the applicable COBRA premium amount.

Due in large part to the fact that COBRA premiums are based on the law of averages, the current rules governing COBRA premium determinations fail to take into account many factors that would be essential as part of any valuation exercise, including differences in workforce populations, employee age, geographical differences in costs and standards of living, and actual claims experience among covered employees. Accordingly, current COBRA premiums are ill-suited for use as part of any taxing regime of employer-provided health coverage and are likely to significantly overstate tax liability for many employees who would be subject to a limitation or elimination of the current employee exclusion. Moreover, as the above discussion is intended to illustrate, adjusting for all of the necessary variations to ensure that health care coverage is taxed in a fair and equitable manner is very difficult if not impossible.

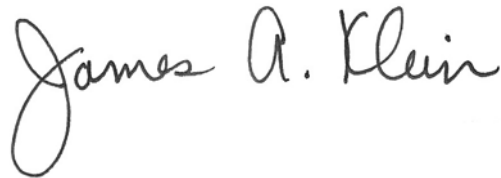
***Current tax rules for account-based health plans, such as HSAs, HRAs and FSAs, should be maintained.*** Lastly, the Council notes that there is a discussion of several financing options with respect to HSAs, HRAs, and FSAs on pages 21-24 of the Committee's

options paper. Regarding HSAs, some of the suggested options include reducing the current contribution limits to the lesser of an individual's deductible and the statutory maximum contribution, increasing the penalty for non-qualified withdrawals from 10 percent to 20 percent, and requiring third party substantiation. Regarding FSAs, the options generally are limiting the amounts that can be contributed to an FSA or eliminating FSAs altogether.

Recent data makes clear that HSAs, HRAs, and FSAs are utilized by many employers as an integral component of their health plan offerings and that both employers and employees are generally very satisfied with account-based health plans.<sup>9</sup> Because many employers and employees depend on these plans to help pay for and access essential medical coverage for themselves and their families, the Council and its members strongly urge the Committee not to eliminate or discourage the use of HSAs, HRAs, or FSAs.

Thank you again for the opportunity to provide the Council's perspectives as the Committee undertakes the vital work of reforming the nation's health care system. We look forward to continuing to work with you and your colleagues as the Committee prepares for the consideration of comprehensive health reform legislation.

Sincerely,

A handwritten signature in black ink that reads "James A. Klein". The signature is written in a cursive style with a large, looping initial "J".

James A. Klein  
President

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<sup>9</sup> A survey of 500 HSA accountholders found that approximately 82% are satisfied with their accounts. Press Release, OptumHealth Inc., Health Savings Account Owners: Satisfied with Their Accounts, Want to Keep Them as Savings Option for Americans (May 13, 2009).