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Senator Kerry's Tax on Health Insurance Companies Would Hit Everyone with Insurance

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Members of Congress continue to demonstrate their ingenuity, creativity, and often poor judgment in their increasingly desperate hunt for painless revenue sources to pay for health care reform. Initial projections are that health care reform will cost well north of $1 trillion. To pay for this extraordinary expansion in government spending, Members have considered everything from taxing soda to killer rate hikes on small businesses. Senator John Kerry (D–MA) and others are pushing the idea of imposing $100 billion in special taxes on health insurance companies.

Taxing health insurance companies is a bad, backdoor alternative to the more sensible, more transparent policy of capping the exclusion for employer-sponsored health insurance. Worse, unlike the cap, taxing health insurance companies would hit low- and middle-income workers hard.

Getting Down to Sharp Brass Tacks. Budgeting is about making choices. An important choice the President and Congress made at the outset of the health care reform effort was that any new spending must be offset with other spending reductions or higher taxes. While taxes are already too high, and suggesting a tax hike during the deepest recession in decades is especially wrongheaded, the commitment to "pay for" health care reform was laudable. The devil as always is in the details, however, and finding easy ways to pay for a massive expansion of government is proving very difficult, giving rise to a variety of bad ideas.

One such bad idea is the Kerry proposal to impose special levies on health insurance companies. An argument raised in support of this legislation is that the top 10 health insurance companies reportedly earned $12.9 billion in 2007. This figure is cited as though that sum alone justifies a more punitive tax. One wonders what level of profits would have been appropriate for the industry in the eyes of the Senate.

The naive view behind the special levy on health insurance companies, as evidenced by the citing of the profits figure, is that the tax would be paid out of company profits by the owners of the companies—the shareholders. The obvious reality is that the companies would pass these higher tax levies onto their customers (i.e., those purchasing health insurance) in the form of higher premiums. If Congress raised the federal gas tax, the price of gas at the pump would jump. If Congress imposes a special levy on health insurance companies, the price of insurance jumps. It is that simple.

This proposal reflects a backdoor approach to a more promising proposal of capping the exclusion for employer-provided health insurance, as reportedly favored by Senate Finance Committee Chairman Max Baucus (D–MT) and Ranking Member Charles Grassley (R–IA). For example, if the exclusion cap is $12,000 and an individual receives

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health insurance through his employer valued at $10,000, then he is unaffected. But if his insurance is valued at $14,000 and he faces a combined 30 percent tax rate, then his costs for buying the more expensive insurance will go up by $600 annually.[1]

From both tax and health policy perspectives, this proposal has merit if it is used to offset the budget effects of other tax reductions—that is, as part of a tax-neutral package. The health insurance exclusion distorts labor compensation and health care decisions and contributes to the excessive use of health care. Its benefits go disproportionately to those who have employer-provided insurance, those who can afford to receive more of their income in tax-exempt benefits, and those who face the highest tax rates.

Capping the exclusion for employer-sponsored health insurance would raise the after-tax cost of more generous health insurance policies, and this would be immediately apparent to the insurance policy owner. In contrast, Senator Kerry's plan to tax health insurance companies would drive up premiums, raising the after-tax cost of insurance for everybody. In both cases, some insured individuals and families will face higher after-tax insurance costs, but there are two important substantive differences between capping the exclusion versus taxing health insurance companies:

1. *Transparency, or lack thereof.* With a cap in place, individuals facing higher taxes would immediately know that the higher taxes result from their more generous health insurance policies. The only reason to tax health insurance companies rather than capping the exclusion is in the vain hope that insurance purchasers—a.k.a. taxpayers, a.k.a. voters—will not notice that Congress has caused their premiums to go up.
2. *Who pays the tax.* With an exclusion cap, individuals can minimize or avoid the tax by adjusting the amount of health insurance they buy through their employers. And those who still pay the tax are very likely to be upper-income individuals. In contrast, everybody with insurance pays the Kerry health insurance company tax through higher premiums whether they have a low-cost plan or a high-cost plan, whether they are low-income or high-income customers. It is certainly odd that Senator Kerry and his colleagues would seek to impose higher costs on low-income workers in this fashion.

Another Step Toward Government-Run Health Care? The Kerry special tax on health insurance companies is apparently intended to fall only on private health insurance companies. However, the President and many health care reform advocates are insistent on some form of "public plan." So far, advocates of the health insurance company tax have remained silent on one very important detail: whether the new tax would be levied on the public plan as well.

Of course, if the public plan was not subject to the tax, then this would be just another feature of health care reform designed to ensure the rapid evolution toward universal, government-run health care as taxes drive private plans out of the business.

Sensibly Paying for Promises. The easy part of health care reform was promising new benefits to millions of Americans. Unrestrained, Congress's penchant is to take the "all of the above" approach as exemplified by the bill developing under Senator Ted Kennedy's (D-MA) direction. However, the President and Congress have agreed to a critical restraint: The plan must be budget neutral.

This means spending reductions elsewhere or tax hikes to pay for the desired massive expansion of government. The proposed "pay for" offered by Senator Kerry and others—to levy a special tax on health insurance companies—is a wrongheaded, backdoor alternative to a thoroughly defensible proposal of capping the exclusion for employer-sponsored health insurance in a tax-neutral bill. The Kerry proposal fails the test of transparency, and would inexplicably impose extra burdens on low-income workers and their families.

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1. See Stuart M. Butler, "How to Devise a Tax Cap in Health Care Reform," Heritage Foundation *WebMemo* No. 2517, July 1, 2009, at *http://www.heritage.org/Research/HealthCare/wm2517.cfm.*

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