

## COMMENTARY

### Level Playing Fields and Inconsistent Rules: A Risky Combination

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“Employer-sponsored health insurance is tax-free, but people who buy their own coverage receive no tax breaks. Policymakers should level the playing field by giving every form of health coverage the same tax treatment.”

This initially appealing claim misses some key facts. Insurance companies will not sell to employers unless at least 75 percent of workers accept coverage offers.<sup>1</sup> Currently, according to the Treasury Department, the unequal tax treatment of employer-sponsored insurance (ESI) and nongroup coverage “can increase the after-tax cost of [nongroup] insurance ... by as much as 50 percent.”<sup>2</sup> If this inequality ended and many workers left ESI for nongroup coverage, some companies would no longer meet insurers’ minimum participation requirements and would lose the ability to offer coverage.

These participation requirements have particularly serious implications for proposals that maintain or increase current differences between the rules for insurers that sell directly to individuals and those that sell to employer groups. For example, Senator McCain’s health proposal would repeal the current exclusion of employer insurance payments from income subject to federal income taxation. McCain would substitute a federal income tax credit that could be used either for ESI or nongroup coverage.<sup>3</sup> Federal law prohibits an employer from charging higher premiums or providing fewer benefits to workers who are older or who have health problems. By contrast, under both current law and the McCain plan, the consumer’s age, gender, and health status can determine nongroup premiums, available benefits, and whether coverage is offered at all.

At small firms with fewer than 100 workers, 21 percent of employees with ESI are under age 30.<sup>4</sup> Another 14 percent are age 30 to 44 and report excellent health. Because nongroup insurance typically costs less for healthier people, many of these young and healthy workers would save money if they used a McCain-style tax credit to buy nongroup coverage rather than ESI, even if that meant forgoing the after-tax value of their employers’ health insurance contributions.

Employers that can no longer meet the insurance industry’s 75 percent participation requirement would lose the labor market advantages of offering health insurance to attract and retain essential workers. More important, many employees and dependents who would like to continue receiving coverage from their employers could no longer do so. They might be able to shift to the nongroup market, but those who are older or sicker could be denied affordable, comprehensive insurance.

Others have observed that, if younger and healthier workers shift from ESI to nongroup coverage, average costs will increase for the remaining recipients of employer-based coverage, potentially causing a further exodus from ESI.<sup>5</sup> Inability to meet insurers’ participation requirements is a second reason why, as long as ESI and nongroup coverage operate very differently, equalizing the tax treatment of these two forms of insurance could prove dangerously destabilizing to employer-based coverage. Put simply, if health insurance markets continue to play by different rules, policymakers should beware leveling the federal income tax playing field.

## Notes

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<sup>1</sup> Janet Trautwein, personal communication, September 2008, reporting on an internal survey of members by the National Association of Health Underwriters.

<sup>2</sup> U.S. Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2008 Revenue Proposals*, February 2007 (Blue Book).

<sup>3</sup> Senator McCain's proposal would preserve the current favored status of ESI for payroll tax purposes

<sup>4</sup> Calculations by Allison Cook, Urban Institute, March 2008 Current Population Survey: Annual Social and Economic Supplement (CPS-ASEC or CPS).

<sup>5</sup> Linda J. Blumberg and John Holahan, *An Analysis of the McCain Health Care Proposal*, Urban Institute, September 22, 2008.