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Congress of the United States

U.S. House of Representatives
Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515-6315

Memorandum

To: Members, Subcommittee on Health and Technology
From: Committee Staff
Date: May 6, 2013
Re: Hearing: "The Health Insurance Fee: Impact on Small Businesses"

On May 9, 2013, the Subcommittee on Health and Technology will meet for the purpose of receiving testimony on the Patient Protection and Affordable Care Act's annual fee on health insurance.[1]

I. Introduction

More than half of all Americans obtain health insurance through their employer.[2] According to the Kaiser Family Foundation, in 2012, 61% of firms offered group insurance policies to their employees.[3] Offer rates vary, with large employers more likely to offer coverage.[4] In 2012, the cost of a typical individual policy is about $6,000 per year.[5]

To help pay for expanding the availability of health insurance, the Patient Protection and Affordable Care Act requires that, beginning in 2014, an annual fee be assessed on United States companies that are engaged in the business of providing health insurance.[6] Several analyses of this fee have concluded that it is likely to be passed on to purchasers of health insurance, many of them small businesses, in the form of higher premiums.[7]

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[1] The health insurance annual fee [hereinafter "insurance fee" or "fee"].
[2] THE UNINSURED: A PRIMER 2, KAISER FAMILY FOUNDATION (OCTOBER 2012), *available at* http://www.kff.org/uninsured/upload/7451-08.pdf.
[3] *Id.*
[4] *Id.* at 2.
[5] *Id.*
[6] Pub. L. No. 111-148 § 9010(a), 124 Stat. 865 (2010). There are exceptions for employers that self-insure, certain non-profit insurers and some governmental entities. § 9020(e)(2), 124 Stat. 866.
[7] *See* Letter from Douglas Elmendorf, Director, Congressional Budget Office, to The Honorable Evan Bayh (November 30, 2009), *available at* http://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/107xx/doc10781/11-30-premiums.pdf; *and* ANNUAL TAX ON HEALTH INSURERS ALLOCATED BY STATE, OLIVER WYMAN (2011), *available at* http://www.google.com/url?sa=t&rct=j&q=&esrc=s&frm=1&source=web&cd=1&ved=0CDAQFjAA&url=http%3A%2F%2Fwww.ahip.org%2FWymanState%2F&ei=j_NJUaekOrao4APg-ICYCw&usg=AFQjCNFVme4oP4liGSogvfK5SsGtecglRQ&bvm=bv.44011176,d.dmg.

II. Types of Private Health Insurance

During World War II, employers began offering health insurance as an employee benefit.[8] In the 1950s, it was determined that employer-provided health insurance is not taxable as income.[9] Since that time, most Americans have obtained health insurance through their employer.

A. Fully-Funded Group Insurance

In the United States, group insurance is usually obtained through an employer or union, which purchases a fully-funded plan from a commercial insurance company (such as Aetna or Cigna) or a non-profit association. Fully-funded group plans spread the risk of policyholder claims by assuming that a number of people will enroll in the plan,[10] and the cost of the policy and claims is apportioned among those who are insured.[11] This is known as indemnity insurance.[12] Typically, the employee pays the provider for medical care and the insurer reimburses the employee.[13] Premiums are usually fixed for one year, and the monthly premium changes only if the number of employees enrolled changes. Premiums have been set based on the experience of the insured employees' medical claims during the previous year,[14] and rise at a gradual rate. Most small businesses in the United States purchase fully-funded plans, and these are subject to the new insurer's fee under the health care law.

B. Self-Funded Insurance

Some larger employers and unions do not purchase insurance from health insurance companies. They self-insure, meaning they assume the risk themselves because they believe they can safely project their annual medical expenditures and lower administrative costs.[15] The administration of self-funded plans is similar to fully-funded ones in several ways. First, the company sets aside funds in lieu of a premium paid to an insurance company. Next, a set amount is put aside for administrative fees, and finally, a portion is put aside for employee health care. When an employee has a claim, it is submitted to the employer without an insurance company as intermediary.[16] Some companies contract with an outside firm to handle administrative tasks, such as collection of "premiums" and payment of claims.[17]

Full self-insurance is rare, however, so a company may also reinsure, contracting with a private insurance company for a policy to guard against high or catastrophic losses.[18] Some analysts say that reinsurance has been accelerated by government policies that imposed the premium tax, because self-insured employers knew that tax would be passed along to customers via higher premium costs.[19]

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[8] J. STUART SHOWALTER, THE LAW OF HEALTHCARE ADMINISTRATION 39 (6th ed. 2011).
[9] I.R.C. § 105.
[10] LEIYU SHI AND DOUGLAS A. SINGH, DELIVERING HEALTH CARE IN AMERICA 207 (2012).
[11] *Id.*
[12] The company is essentially indemnifying the employee for the cost of health care. DONALD A. BARR, INTRODUCTION TO U.S. HEALTH POLICY 101 (3rd ed. 2011).
[13] DONALD A. BARR, INTRODUCTION TO U.S. HEALTH POLICY 101 (3rd ed. 2011).
[14] This was known as "experience rating." DONALD A. BARR, INTRODUCTION TO U.S. HEALTH POLICY 102 (3rd ed. 2011).
[15] MARK O. DIETRICH AND GREGORY D. ANDERSON, THE FINANCIAL PROFESSIONAL'S GUIDE TO HEALTHCARE REFORM 50, 56-57 (2012).
[16] DONALD A. BARR, INTRODUCTION TO U.S. HEALTH POLICY 101-2 (3rd ed. 2011).
[17] *Id.* at 102-3.
[18] LEIYU SHI AND DOUGLAS A. SINGH, DELIVERING HEALTH CARE IN AMERICA 207-208 (2012).
[19] *Id.*

Self-insured plans are largely exempt from the health insurance tax. Since large companies are more likely to self-insure, it has been assumed that the health insurance tax would result in smaller premium increases for them than for small firms.[20] A recent NFIB study reinforces this, predicting that the premium tax will be shifted to consumers, many of whom are small employers and their employees that are in fully-funded plans offered by insurers.[21]

III. The Annual Fee on Health Insurance

Under the Patient Protection and Affordable Care Act,[22] beginning in 2014, an "annual fee" will be assessed on certain United States companies engaged in the business of providing health insurance.[23] The fee is calculated based on the net premiums collected for the policies the company has written during the previous calendar year.[24] The Internal Revenue Service calculates each insurer's fee based on information reported by the insurer.[25] A penalty will be assessed for the failure to report, or the underreporting of, the company's net premiums.[26]

The fee is apportioned annually among all covered health insurance providers and based on their net premiums written.[27] The aggregate amount of the fee for all insurers totals $8 billion for 2014;

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[20] *Id.*

[21] MICHAEL J. CHOW, EFFECTS OF THE PPACA HEALTH INSURANCE PREMIUM TAX ON SMALL BUSINESSES AND THEIR EMPLOYEES: AN UPDATE, NFIB RESEARCH FOUNDATION (March 19, 2013), *available at* http://www.nfib.com/research-foundation/studies/hit-cost/state-analysis.

[22] Pub. L. No. 111-148, 124 Stat. 119 (2010).

[23] Pub. L. No. 111-148 § 9010(a), 124 Stat. 119, 865 (2010). There are exceptions for employers that self-insure, certain non-profit insurers and some governmental entities. § 9020(e)(2), 124 Stat. 866.

[24] § 9010(b)(1), 124 Stat. 866 (2010). The fee on health insurance providers is divided among insurers according to a formula based on each insurer's net premiums. *Id.* An insurer's pro rata share is generally its net premiums written minus the first $25 million and 50% of the second $25 million, but not more than $50 million, and 100% of premiums over $50 million. § 9010(b)(2)(A). For non-profit insurers, only 50% of net premiums are taxed. *See also* 78 Fed. Reg. 14,034, 14,035.

[25] Insurers (even those with net premiums below $25 million) will report net premiums written to the IRS annually on IRS Form 8963 ("Report of Health Insurance Provider Information"). 78 Fed. Reg. 14,038. The IRS will notify insurers of their fee annually by August 31, and insurers will pay the fee electronically no later than September 30. *Id.*

[26] Pub. L. No. 111-148, § 9010(g)(2)(b), 124 Stat. 119, 867 (2010). The penalty is equal to the excess of the amount of the covered entity's fee for the fee year that the Secretary determines that should have been paid in the absence of the understatement, over the amount of the fee that the Secretary determined based on the understatement. Pub. L. No. 111-148, § 9010(g)(3)(B). 124 Stat. 119, 866 (2010).

[27] Section 9010 of the health care law does not define "net premiums written" for health insurance. The Internal Revenue Service's proposed rule on the health insurance providers fee define the term as "premiums written, including reinsurance premiums written, reduced by reinsurance ceded and reduced by ceding commissions and medical loss ratio rebates." The items "ceded" are the expenses the company is likely to incur by writing the insurance contract. 78 Fed. Reg. 14,034. The amount of net premiums written that is taken into account for each covered per calendar year is 0% of net premiums written up to and including the first $25 million; 50% of net premiums written that are more than $25 million but not more than $50 million, and 100% of net premiums written that are over $50 million. *Id.*

$11.3 billion for 2015-2016; $13.9 billion for 2017; and $14.3 billion for 2018.[28] After 2018 and thereafter, the amount rises in relation to an index based on the growth of net premiums.[29]

The fee applies to fully-insured coverage; self-funded coverage is exempt.[30] The Joint Committee on Taxation's June 15, 2012 revenue estimate for the Ways and Means Committee estimated that the fee will generate $101 billion from the industry over ten years,[31] making it one of the most lucrative revenue provisions of the health care law. Importantly, the JCT has said the fee "is similar to an excise tax based on the sales price of insurance contracts[32] and it considers the fee to be "a nondeductible tax"[33] to insurers, increasing its impact on insurers.

IV. Estimated Effect of the Health Insurance Fee

In a November 2009 analysis, the Congressional Budget Office (CBO) did not evaluate the specific effect of the insurance fee on average health insurance premiums, but stated that "[n]ew fees would be imposed upon providers of health insurance and on manufacturers and importers of medical devices. Both of these fees would be largely passed through to consumers in the form of higher premiums for private coverage."[34] Similarly, the Joint Committee on Taxation estimated that "....we expect a very large portion of the insurance industry fee to be passed forward to purchasers of insurance in the form of higher premiums."[35] JCT also estimated that "eliminating this fee could decrease the average family premium in 2016 by $350 to $400."[36]

Large companies typically self-insure, and self-insured plans are exempt from the insurance fee. As a result, premium increases due to the insurance fee are likely to fall more heavily on small businesses and their employees, who typically purchase the fully-funded plans that are subject to the fee.

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[28] *Id.* at 14,045. *See also* Letter from Thomas A. Barthold, Chief of Staff, to The Honorable Jon Kyl (June 3, 2011), *available at* http://www.ahipcoverage.com/wp-content/uploads/2011/11/Premium-Tax-JCT-Letter-to-Kyl-060311-2.pdf.

[29] *Id.*

[30] *Id.* Plans that are subject to the fee include those providing Medicare Advantage, Medicare Part D or Medicaid and multiple welfare arrangements, but only to the extent they are not fully insured. Plans that receive more than 80% of their premiums from government programs for the poor, elderly and disabled, are exempt from the fee. § 9010(b)(2)(B). *See also* 78 Fed. Reg. 14,034, 14,035.

[31] Memorandum from Thomas A. Barthold, Chief of Staff, Joint Committee on Taxation 1 (June 15, 2012), *available at* http://waysandmeans.house.gov/uploadedfiles/jct_june_2012_partial_re-estimate_of_tax_provisions_in_aca.pdf.

[32] *Id.* at 2 (June 12, 2012), *available at* http://waysandmeans.house.gov/uploadedfiles/jct_june_2012_partial_re-estimate_of_tax_provisions_in_aca.pdf

[33] PRESENT LAW AND BACKGROUND RELATING TO THE TAX-RELATED PROVISIONS IN THE AFFORDABLE CARE ACT, JOINT COMMITTEE ON TAXATION (JCX-6-13), *available at* https://www.jct.gov/publications.html?func=startdown&id=4511. The proposed rule also treats the fee as an excise tax for which no deduction is allowed. 78 Fed. Reg. at 14,036.

[34] Letter from Thomas A. Barthold, Chief of Staff, Joint Committee on Taxation (June 3, 2011) to The Honorable Jon Kyl 5, *available at* http://www.ahipcoverage.com/wp-content/uploads/2011/11/Premium-Tax-JCT-Letter-to-Kyl-060311-2.pdf.

[35] *Id.*

[36] *Id.*

Several studies have examined the effect of the fee on insurance premiums in the small group market. A 2013 study by the NFIB Research Foundation[37] estimates that the insurance fee may raise the cost of employer-sponsored insurance by 2% to 3% per year.[38] This study also projects that these price increases could reduce private sector employment by 146,000 to 262,000 jobs in 2022, with the majority of those losses falling in the small business sector.[39]

A 2011 analysis by actuarial firm Oliver Wyman estimated that the insurance fee "will increase premiums in the insured market on average by 1.9% to 2.3% in 2014,"[40] and by 2023 "will increase premiums by 2.8% to 3.7%."[41] Oliver Wyman's 2012 report estimated the impact the fee will have on individuals, employers, and Medicare Advantage beneficiaries in all 50 states.[42] It projected annual premium increases due to the fee of 1.8% in 2014 and 2.8% by 2018-2013. On average across all states, additional premiums to be paid over the ten-year period would increase by $2794 for single coverage and $5140 for family coverage in the small group market.[43] In addition, a recent survey of health insurers estimated that employer-sponsored health insurance premiums could rise by 2.4% to 3% between 2014 and 2019.[44] Note that these estimates consider only the percentage of premium increases attributable to the insurance fee, and not to other factors that may cause higher premiums.

The 2011 Oliver Wyman study projects the fee will increase small group market premiums beginning in 2014 by an average of about $2,800 for an individual and $6,800 over a ten-year period.[45] An analysis of health insurance plans found that certain individuals and small businesses could face dramatic premium increases in 2014 as a result of the fee.[46]

V. Conclusion

This hearing will provide an opportunity for Members to learn more about one of the largest fees in the health care law, and its estimated effect on small businesses.

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[37] MICHAEL J. CHOW, EFFECTS OF THE PPACA HEALTH INSURANCE PREMIUM TAX ON SMALL BUSINESSES AND THEIR EMPLOYEES: AN UPDATE, NFIB RESEARCH FOUNDATION (March 19, 2013), *available at* http://www.nfib.com/research-foundation/studies/hit-cost/state-analysis.

[38] *Id.* at 1.

[39] *Id.*

[40] CHRIS CARLSON, ESTIMATED PREMIUM IMPACTS OF ANNUAL FEES ASSESSED ON HEALTH INSURANCE PLANS 1, OLIVER WYMAN (October 31, 2011), *available at* http://www.ahipcoverage.com/wp-content/uploads/2011/11/Insurer-Fees-report-final.pdf.

[41] *Id.*

[42] CHRIS CARLSON, ANNUAL TAX ON INSURERS ALLOCATED BY STATE, OLIVER WYMAN (November 2012), *available at*

[43] *Id.* at 4.

[44] DOUGLAS HOLTZ-EAKIN, HIGHER COSTS AND THE AFFORDABLE CARE ACT: THE CASE OF THE PREMIUM TAX, AMERICAN ACTION FORUM (MARCH 9, 2011), *available at* http://americanactionforum.org/sites/default/files/Case%20of%20the%20Premium%20Tax.pdf.

[45] *Id.* at 1.

[46] DOUGLAS HOLTZ-EAKIN, INSURANCE PREMIUMS IN 2014 AND THE AFFORDABLE CARE ACT: SURVEY EVIDENCE 1, AMERICAN ACTION FORUM (JANUARY 2013), *available at* http://americanactionforum.org/sites/default/files/AAF_Premiums_and_ACA_Survey.pdf.