

REPORT OF THE COUNCIL ON MEDICAL SERVICE

CMS Report 8 - I-08

Subject: Tax Deductibility of Employer Contributions Toward
Employee Health Insurance and Health Care Expenses

Presented by: David O. Barbe, MD, Chair

1 At the 2008 Annual Meeting, the House of Delegates adopted as amended the recommendations
2 contained in Council on Medical Service Report 8, "Standardizing AMA Policy on the Tax
3 Treatment of Health Insurance." Recommendation 16 amended the report and called for the
4 American Medical Association (AMA) to study the effect of changing the tax system from the
5 deductibility of health care "expenses" to the deductibility of "insurance premiums" on self-insured
6 employers and report back to the House of Delegates at the 2008 Interim Meeting.
7 Recommendation 16 raised concerns with other recommendations of Council on Medical Service
8 Report 8-A-08, which were adopted by the House, that amended several AMA policies by
9 replacing the term "health expense coverage" with "health insurance."

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11 The Board of Trustees referred the requested study to the Council on Medical Service for a report
12 back to the House at the 2008 Interim Meeting. This report, which is provided for the information
13 of the House, clarifies the intent and expected impact of substituting the language "health expense
14 coverage" with "health insurance" in AMA policy as adopted by the House of Delegates in June. It
15 also clarifies any misunderstanding regarding whether Council on Medical Service Report 8-A-08
16 created new policy regarding the tax treatment of health insurance.

17 BACKGROUND

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20 The tax treatment of health insurance as it currently exists, and as it would exist under the AMA
21 proposal to expand health insurance coverage and choice, have recently been described in the
22 following AMA publications and reports:

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24 • Council on Medical Service Report 5-I-07, "Tax Implications of Eliminating the Employee
25 Income Tax Exclusion for Employer-Sponsored Insurance";
- 26 • Council on Medical Service Report 8-A-08, "Standardizing AMA Policy on the Tax
27 Treatment of Health Insurance";
- 28 • Council on Medical Service Report 8-I-08, "The Tax Treatment of HSAs," also currently
29 before the House; and
- 30 • A series of AMA advocacy publications, which were distributed to the House at the 2008
31 Annual Meeting and are available at www.VoiceForTheUninsured.org.

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33 For the past decade, the AMA has advocated expanding health insurance coverage and choice by
34 replacing the existing employee income tax exclusion for employer-sponsored coverage with
35 individual tax credits for health insurance that are refundable, inversely related to income, and
36 applicable to coverage of the recipient's choice, whether job-related or not. Specifically, Council
37 on Medical Service Report 9-A-98, established 17 principles fostering individually owned health
38 insurance. Following is the ninth of these 17 principles:

1 That AMA policy express a preference for replacement of the present exclusion from
2 employees' taxable income of employer-provided health expense coverage with a tax
3 credit for individuals equal to a percentage of the total amount spent for health expense
4 coverage by the individual and/or his/her employer, up to a specified actuarial value or
5 "cap" in coverage so as to discourage over-insurance. (Recommendation 9 of Council on
6 Medical Service Report 9-A-98).

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8 Over the past decade, the policy established by this recommendation has been modified. Most
9 recently, the reference to "health expense coverage" was updated and clarified by Council Report
10 8-A-08. However, support for replacing the employee income tax exclusion with tax credits has
11 remained a core principle (Policy H-165.920[11], AMA Policy Database). The AMA reform
12 proposal would redirect the estimated \$125 billion annual government subsidy for private coverage
13 toward those most likely to be uninsured i.e. those with lower incomes, while also expanding
14 individual choice by leveling the playing field between employer-sponsored insurance and
15 individually purchased insurance.

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17 For purposes of both the current and proposed tax treatment of health insurance, it does not matter
18 whether coverage takes the form of a fully insured or a self-insured health plan. Most employers
19 with 100 or more employees, and some smaller firms, "self-insure" as provided for under the
20 Employee Retirement Income Security Act of 1974 (ERISA). Rather than paying premiums to an
21 insurer to assume responsibility for employees' covered health care expenses, employers with
22 ERISA plans bear the financial risk of covering their employees themselves, relying on insurers
23 simply as third-party administrators to assist with claims management and similar activities.
24 Employers who offer a choice of health plans may offer both fully insured and ERISA plans. All
25 employer-sponsored health plans are subject to basic federal standards regarding fiduciary
26 responsibility, patient information access, due process and appeals, and accessibility of coverage,
27 but self-insured ERISA plans are exempt from many state regulations. The majority of people with
28 employer-sponsored health insurance are enrolled in ERISA plans. Regardless of whether a health
29 plan is fully insured or self-insured by the employer, employer expenditures on employees' health
30 care coverage are currently excluded from the insured employee's federal income tax. Employer
31 expenditures on employees' health care coverage are also currently deductible by the employer as a
32 business expense, and would continue to be so under the reformed tax treatment of health insurance
33 proposed by the AMA.

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35 Under the AMA reform proposal, for purposes of taxes, there would be no distinction between
36 fully insured and self-insured health plans, and employer-paid defined contributions toward
37 employee-purchased coverage (Policy H-169.920[3a]). In all cases, the employer's costs for
38 employee coverage would become subject to the employee's federal income tax, the individual
39 could apply any tax credit toward the coverage, and, as noted, the employer could continue to
40 deduct such outlays as a business expense. Finally, as noted in Council on Medical Service Report
41 8-I-08, "The Tax Treatment of Health Savings Accounts," also before the House at this meeting,
42 current AMA policy regards both components of a health savings account (HSA), the traditional
43 health plan and the individual savings account, as "health insurance" for tax purposes. AMA
44 principles for structuring tax credits (Policy H-165.865[1i]) make it clear that HSA coverage
45 should qualify for the same tax treatment as other forms of health insurance coverage. Specifically,
46 tax credits could be used to pay premiums for an HSA-qualified high-deductible health plan or to
47 make contributions to an associated HSA account.

1 DISCUSSION

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3 The Council appreciates the opportunity to further articulate the intent and implications of
4 modifications to AMA policy discussed in Council on Medical Service Report 8-A-08.
5 Recommendation 16 of the report called for the study of the effect of changing the tax system from
6 the deductibility of health care “expenses” to the deductibility of “insurance premiums,” with
7 special attention to the impact on self-insured employers. The Council notes that the
8 recommendations of Council Report 8-A-08, which were adopted by the House of Delegates, do
9 not call for a change in the types of health-related expenses that are tax deductible, nor do they call
10 for the addition of the term “premiums,” as suggested by Recommendation 16. Rather, the
11 linguistic modifications improve the clarity of long-standing AMA policy, and do not represent a
12 shift in policy. As Council Report 8-A-08 states, the term “health insurance” is preferable to
13 “health expense coverage” because it is widely used and understood, with substantially the same
14 meaning.

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16 Specifically, the Council believes that the effect of these modifications was to clarify long-standing
17 AMA policy supporting replacement of the employee income tax exclusion of employer-provided
18 health benefits with appropriately structured tax credits applicable to coverage of the recipient’s
19 choice. These proposed changes in the tax treatment of health insurance are central to achieving
20 the AMA reform objectives of redirecting the estimated \$125 billion annual government subsidy
21 for private coverage toward those most likely to be uninsured, i.e., those with lower incomes, while
22 also expanding individual choice by leveling the playing field between employer-sponsored
23 insurance and individually purchased insurance.

References for this report are available from the AMA Division of Socioeconomic Policy
Development.