ISSUE MEMORANDUM

Taxes in the Clinton Health Plan

Although the mandated payments to health alliances constitute the vast bulk of the revenues to pay for President Clinton's health proposal, there are also many additional tax increases in the plan. Although these increases are not large individually, they add up to significant levels over time. Since these taxes have gotten less attention than other aspects of the Clinton plan, this memorandum will review these other taxes.

Tobacco taxes. Presently the Federal Government taxes tobacco products the equivalent of 24 cents per pack of cigarettes. The Clinton plan would increase these taxes by 74 cents per pack to 99 cents per pack. Although this constitutes a tripling of the tobacco tax, the Clinton Administration does not forecast a tripling of tobacco tax revenues. Tobacco taxes presently raise about $5.6 billion and the Clinton plan would increase this figure by $12 billion in the first year, falling to $10.9 billion in the sixth year. The Congressional Budget Office forecasts a smaller increase in revenue: $11 billion the first year, falling to $10 billion after five years.

The reason why tobacco tax revenues would not rise proportionally to the increase in the tax rate is because the higher taxes will affect behavior. People who smoke will smoke less or even quit, fewer people will become smokers, and there will be some increase in cigarette smuggling to avoid paying taxes. Evidence from the states suggests that each 1% increase in the cigarette tax will only increase revenues by 0.5% because of these effects.

Exclusion of health insurance from cafeteria plans and limitation of employer deduction for health benefits. At present, most benefits provided to workers and retirees by their employers, including health benefits, are not taxable. Employers deduct their cost as a regular business expense, but employees do not pay taxes on such benefits. Some companies have what are called cafeteria plans, which allow employees to choose an individual mix of benefits. For example, some employees might prefer more health benefits and lower pension benefits or vice versa. The Clinton proposal would exclude health benefits from such plans. It would also limit the tax exclusion for health benefits to the cost of the basic health plan under the Clinton proposal. The value of benefits over and above this amount would be considered taxable income to employees.

Assessment on corporate alliances. Under the Clinton

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plan, all individuals would have to get their health insurance from regional alliances. However, large corporations are allowed to set up their own separate corporate alliances. Employers setting up such corporate alliances would be assessed 1% of their total payroll for the privilege of doing so.

Assessment on employer-provided health benefits for retirees. At present, many corporations continue to provide health benefits for retired workers. Since, under the Clinton plan, such benefits would in the future be provided by the Federal Government, these corporations in effect receive a windfall, by being relieved of an expense they would otherwise have incurred. The Clinton plan would tax 50% of such gains.

Increase in Medicare premiums for certain high-income individuals. At present, the Medicare program has two parts, A and B. Part A provides hospital benefits to individuals over age 65 at no charge. Part B provides supplementary benefits, such as doctors' visits, and is financed by premiums paid by those who choose this additional medical coverage. These premiums, however, only cover about 25% of the actual cost of the program, the balance (75%) being covered by taxpayers. The Clinton plan would reduce this subsidy for certain high-income individuals (those with incomes over $90,000), requiring them to pay 75% of the cost of Medicare Part B, rather than the current 25%.

Extension of self-employment taxes to distributions from Subchapter S corporations. At present, self-employed workers pay a self-employment tax equal to both the employees' and employers' share of the Social Security payroll tax (15.3% on the first $57,600 of wages and 2.9% on the next $77,400). The Clinton plan would extend this tax treatment to distributions from Subchapter S corporations. These are small companies which combine certain tax benefits of corporations and partnerships. Thus any shareholder in such a company owning more than 2% of the equity who received profits from this company during a year would have to pay an additional 15.3% tax on the first $57,600 and 2.9% on the balance up to $135,000.

Extension of health insurance payroll tax to all state and local government employees. At present, state and local government employees hired before April 1, 1986, generally do not pay the health insurance portion of the payroll tax (1.45% on both employer and employee up to $135,000 of wages). The Clinton plan would extend the HI tax to these currently excluded workers.

This is a brief overview of just the major tax increases proposed by the Clinton health plan. Further information can be obtained from the Joint Committee on Taxation of the U.S. Congress in a publication entitled, Description and Analysis of Title VII of H.R. 3600, S. 1757, and S. 1775 ("Health Security Act"), JCS-20-93 (December 20, 1993). The following table indicates the revenue effects of the tax proposals reviewed as well as others in the plan.

--Bruce Bartlett, Senior Fellow March 3, 1994

FINANCING THE HEALTH SECURITY ACT
(billions of dollars)

	1995	1996	1997	1998	1999	2000	1995-2000
Medicare	**2.1**	**9.0**	**14.2**	**22.1**	**31.6**	**39.2**	**118.2**
Part A Savings	0.0	3.3	7.0	12.0	16.4	20.4	59.1
Part B Savings	1.9	2.4	2.7	5.3	8.7	11.5	32.4
Parts A and B Savings	0.2	1.5	2.2	2.6	4.2	5.0	15.8
HI Tax Extended to all State & Local Government Employees	0.0	1.6	1.6	1.5	1.5	1.5	7.6
Income Related SMI Premium with outlay and premium effects	0.0	0.2	0.9	0.7	0.8	1.0	3.6
Medicaid	**0.0**	**0.5**	**3.5**	**9.2**	**20.1**	**27.1**	**60.5**
Cash-Eligible Beneficiaries in Alliances	0.0	0.3	1.2	3.7	6.6	9.7	21.5
Reduced Disproportionate Share Hospital Payments	0.0	1.0	3.7	10.4	15.2	17.4	47.7
Less Supplemental Services for Children	0.0	-0.1	-0.4	-1.1	-1.6	-1.6	-4.8
Payment Lag, Administrative Savings, and Other Changes	0.0	-0.4	-1.0	-3.8	-0.1	1.6	-3.6
Other Federal Programs	**0.0**	**0.4**	**1.2**	**6.9**	**9.8**	**10.9**	**29.3**
Veterans Affairs: Third Party Receipts	0.0	0.5	1.7	4.4	5.8	6.1	18.5
Defense Department Health (a)	0.0	0.1	0.2	0.7	0.8	0.8	2.6
Federal Employees Health Benefits	0.0	-0.2	-0.7	1.8	3.2	4.0	8.2
Tobacco Tax/Corporate Assessment	**12.0**	**15.0**	**16.2**	**16.2**	**16.1**	**16.1**	**91.6**
Tobacco Tax	12.0	11.3	11.2	11.1	11.0	10.9	67.4
Corporate Assessment	0.0	3.8	5.0	5.1	5.1	5.2	24.2
Other Revenue Effects	**0.1**	**0.8**	**3.4**	**20.0**	**28.5**	**34.5**	**92.6**
Exclusion of Health Insurance from Cafeteria Plans	0.0	0.0	5.8	8.1	8.7	9.8	31.4
Effects of Mandate, Cost Containment, and Discounts	0.0	0.1	0.9	4.4	9.3	13.7	28.4
Dedicated Revenues for Academic Health Centers	0.0	0.5	1.6	4.3	5.5	5.8	17.7
Assessment on Employers for Retiree Discounts	0.0	0.0	0.0	2.4	4.3	4.7	11.4
Anti-Abuse Rule—Certain S Corp. Shareholders	0.0	0.2	0.5	0.5	0.5	0.5	2.2
Modify Tax Treatment of Certain Health Care Organizations	0.0	0.0	0.1	0.2	0.2	0.2	0.7
Reporting Penalties—Non-corp. Ind. Contractors	0.1	0.1	0.1	0.1	0.1	0.1	0.6
Modify Tax Treatment Retirement Funding Accounts	0.0	0.0	0.0	0.0	0.1	0.1	0.3
Recapture Retiree Discounts High-Income Recipients	0.0	0.0	0.0	0.0	0.1	0.1	0.2
Incentives for Health Providers in Shortage Areas	-0.0	-0.0	-0.0	-0.0	-0.0	-0.0	-0.1
Debt Service	**0.3**	**0.6**	**0.5**	**0.2**	**0.8**	**2.0**	**4.2**
TOTAL	**14.5**	**26.7**	**44.0**	**74.7**	**107.0**	**129.8**	**396.8**

(a) Under the proposed legislation, the Secretary of Defense is to decide when the military system will be coordinated with national health reform. The table shows the estimated budgetary effects on the Department of Defense if the military system were to be fully coordinated with national health reform by 1998.

Notes:
These estimates were calculated using the economic assumptions in the 1995 budget. Estimates released in November 1993 were based on the economic assumptions in the 1993 Midsession Review.
The numbers in this table for the years 1994-1999 are drawn from the budget database, except that they include the Vulnerable Population Adjustment and a Medicare adjustment based on more recent data than were available at the time the budget database was completed.

Source: Budget of the United States Government, Fiscal Year 1995 (Washington: U.S. Government Printing Office, 1994), p. 189.

Note: An alternative set of revenue estimates may be found in Congressional Budget Office, An Analysis of the Administration's Health Proposal (Washington: U.S. Government Printing Office, 1994), pp. 28-29. This report also makes the case that the health insurance premiums paid by individuals and businesses to the mandatory health alliances should be treated as taxes. The Clinton Administration has excluded these receipts from its revenue estimates, published above. It should also be noted that the Clinton plan is not fully phased-in until the year 2004, with some taxes not taking effect until that date. Thus this table greatly understates the total increase in taxes under the Clinton plan.