

Effect of the Health Insurer Fee in the Affordable Care Act (ACA) on Health Insurance Premiums

The health insurer fee contained in the ACA will increase costs of taxable health insurers by \$175-200 billion over the 2014 -2023 period, assuming current market shares. This includes \$130 billion attributable to the statutory fees plus \$45 to \$70 billion from the Federal income tax treatment of the health insurer fee.¹

Health Insurer Fee

Beginning in 2014, the ACA imposes a fee on taxable and tax-exempt health insurance providers. The design of the fee specifies the Federal revenue collections. Table 1 shows the annual amount that health insurers must pay.

Year	Fee Amount
2014	\$8.0
2015	11.3
2016	11.3
2017	13.9
2018	14.3
2019*	15.0
2020*	15.8
2021*	16.6
2022*	17.4
2023*	18.3
Total:	\$141.0

*Under the ACA, fee amounts for years after 2018 are determined based on the premium growth rate in the preceding calendar year. The projected fee amounts rely on an assumed 5 percent growth rate in premiums.²

Health Insurer Fee Creates Competitive Disadvantage for Taxable Health Insurers

Health insurers generally pay the health insurer fee in proportion to their share of the health insurance market.³ However, in the case of tax-exempt providers, only 50 percent of their

¹ This analysis does not measure the Federal revenue effects of the health insurer fee, which would incorporate such effects as the income and payroll tax offset that is part of the standard revenue estimating convention applied to excise tax proposals.

² This assumption is consistent with projections by the Centers for Medicare and Medicaid Services. Further, according to a 2013 Towers Watson study, medical costs after plan and contribution changes rose 5.4 percent in 2011, 5.2 percent in 2012, and are expected to increase by 5.1 percent in 2013. See, <http://www.towerswatson.com/en/Insights/IC-Types/Survey-Research-Results/2013/03/Towers-Watson-NBGH-Employer-Survey-on-Value-in-Purchasing-Health-Care>, p. 12.

³ Dollar thresholds apply to the amount of net written premiums taken into account for purposes of the fee. Thus, for any covered entity, the first \$25 million of net written premiums are excluded, 50 percent of net written

premiums are taken into account in determining their share of the health insurer fee. Thus, taxable health insurers face a competitive disadvantage relative to tax-exempt providers because they pay the fee with respect to 100 percent of their premiums.

Table 2 provides an example demonstrating the competitive disadvantage facing taxable insurers in the calculation of their share of the fee. Assume that there are two providers subject to the \$8.0 billion fee in calendar year 2014. In 2013, these entities are (1) a taxable health insurance provider (Taxable Company) with premiums of \$15 billion; and (2) a tax-exempt health insurance provider (Tax-Exempt Provider) with premiums of \$15 billion.

Table 2 shows the calculation of each company's share of the \$8.0 billion fee. While Taxable Company and Tax-Exempt Provider each have a 50 percent share of the health insurance market, Taxable Company will pay 67 percent of the \$8 billion fee and Tax-Exempt Provider will pay only 33 percent.

Company	(a) Net written premiums	(b) Net written premiums taken into account [†]	(d) 50 percent of column (b) for tax-exempt provider	(e) Ratio of amount in column (d) to total for all companies	(f) Allocable share of \$8.0 billion fee [Col. (e) * \$8.0 billion]
Taxable Company	\$15.00	\$14.96	\$14.96	.667	\$5.33
Tax-Exempt Provider	15.00	14.96	7.48	.333	\$2.67
Total:	\$30.00	\$29.92	\$22.44	1.000	\$8.00

[†]Under the ACA, net written premiums taken into account for purposes of the health insurer fee include 0 percent of the first \$25 million, 50 percent of amounts of \$25 million to \$50 million, and 100 percent of amounts \$50 million or more. This provision has the effect of reducing the impact of the fee for very small insurers.

Based on current market shares, taxable health insurers will pay an estimated \$130 billion of the total estimated health insurer fee over the 2014-2023 period.

Federal Tax Treatment of Health Insurer Fee Increases Total Federal Tax Collections Beyond the Statutory Fee Amount

The health insurer fee operates like an excise tax. However, unlike most excise taxes, the taxable health insurer paying the fee may not deduct the amount of the fee for Federal income tax purposes. This ***feature results in the collection of more Federal revenue than intended*** under the statutory provision. Nondeductibility increases the cost of the health insurance fee by an estimated \$45 billion for 2014-2023. Further, if taxable health insurers pass their share of the fee through to their customers in the form of increased premiums, the health insurer must pay

premiums that are more than \$25 million and less than \$50 million are excluded, and 100 percent of net written premiums of \$50 million or more are taken into account.

Federal income taxes on the additional premium income attributable to the passed-through fee.⁴⁵ Thus, a health insurer will transmit its share of the health insurer fee *plus* Federal income taxes on the additional premium income attributable to the amount of the fee passed through to customers.

At a 35 percent marginal tax rate, taxable health insurers must increase premiums by \$1.54 for each \$1 of health insurer fee owed to cover the Federal income tax effects of the fee.⁶ Thus, for \$130 billion of statutory fees for taxable health insurers passed through in the form of premium increases, an additional \$70 billion of additional premium increases would be needed to offset the Federal income tax effects of the fee.

The ability of health insurers to pass through the Federal income tax effects of the health insurer fee depends upon the sensitivity of consumers to price increases. Economists refer to this as the elasticity of the product. Price elasticity measures the percentage change in demand for a product given a percentage change in price. Inelastic demand for a product indicates that consumers do not change their demand for a product with a change in the product's price.

In the case of the health insurance fee, the staff of the Joint Committee on Taxation has indicated that it believes that the health insurance fee will pass through to consumers in the form of premium increases, suggesting that demand for health insurance is relatively inelastic. In a June 3, 2011, letter to Senator Jon Kyl, the Joint Committee stated: "we estimate that repealing the health insurance industry fee would reduce the premium prices of plans offered by covered entities by 2.0 to 2.5 percent."⁷

The ability of taxable health insurers to pass the Federal income tax effects of the health insurer fee through fully to consumers may be mitigated partially by the fact that tax-exempt providers bear a smaller proportion of the fee. However, the share of the health insurance market attributable to tax-exempt providers has remained relatively stable over time. Thus, if these current market shares continue, a significant percentage of the health insurer fee will pass through to consumers – most likely through premium increases.

We estimate that, in addition to the statutory health insurance fee amounts (\$130 billion), taxable health insurers will pass through an additional \$45-\$70 billion to consumers to account for the Federal income tax effects of the fee.⁸

⁴ If a health insurer did not pass through the health insurer fee to customers, then nondeductibility would ensure that the full amount of the fee was paid in Federal revenues. But if any portion of the fee is passed through to customers, nondeductibility increases the total revenue collected with respect to the fee. Economists generally believe that the statutory incidence of a tax does not reflect who ultimately bears the burden of the tax and that business taxpayers will often pass through Federal taxes to their customers.

⁵ If a tax-exempt health insurer passes through its share of the fee, no Federal income taxes are collected on the amounts passed through.

⁶ If x equals the amount of premium income needed to collect \$1 of health insurer fee (net of Federal income tax assuming a 35 percent marginal tax rate), then $x - .35x = \$1$. Thus, $.65x = \$1$ and $x = \$1.54$.

⁷ See Letter of the staff of the Joint Committee on Taxation to Senator Jon Kyl, dated June 3, 2011, available at <http://www.ahipcoverage.com/wp-content/uploads/2011/11/Premium-Tax-JCT-Letter-to-Kyl-060311-2.pdf>.

⁸ These additional costs will most likely result in higher premiums, but the costs could pass through to consumers in such other effects as benefit package modifications.