

Robin Hood Tax Reform:**Modest Changes in Health, Retirement Tax Breaks Could Produce Major Gains in US Health Access, Financial Security – at Little or No Added Government Cost**

First, let's thank the Trump Administration's tax reform agenda for providing political cover for considering changes to the tax exclusion of employee benefits. Though reforming these exclusions could have many positive results, proposing to do so is typically off limits politically. In the summary tax plan released April 26, the Administration defies this political "third rail" by proposing to collect an additional [\\$236 billion in taxes](#) on employees' job-based health benefits, now tax-excluded.ⁱ There are even reports that the President's team was considering doing away with tax breaks on retirement savings and pensions, but these have not been confirmed.

While entirely closing these loopholes would have large – and not all beneficial – impacts on the health care and wages, relatively small adjustments to the treatment of employee benefit tax exclusions could have helpful long-term impacts, while facing less opposition. The positive impacts of two such changes discussed below could include 1) lowering the rate of health care cost inflation; 2) providing revenue to help subsidize health insurance for the unemployed; 3) creating seed money and a low-cost infrastructure for a universal retirement savings system; and 4) increasing retirement security for low- and middle-income people; and 5) helping people save for long-term care costs. Looking at benefit tax exclusion is already on the table as Congress faces the unsavory chore of developing a fix for the Affordable Care Act's (ACA's) clumsily designed "Cadillac" health plan excise tax. Most importantly, these changes could result in greater economic fairness and inclusion.

Employer-provided Health Benefits

Currently employees pay no taxes for employer-provided health benefits. Tax exclusions like this generally face criticism of favoring wealthy over the poor. The higher one's tax bracket, the greater the tax benefit. For example, as a result of tax exclusion, a worker paying taxes at a 35% rate would in effect pay only 65 cents for each dollar of health benefits received, while another paying at a 10% tax rate would in effect pay 90 cents for the same dollar of health benefits.

The Cadillac plan tax, now delayed until 2020, would layer a 40% excise tax on plans costing more than \$10,800 for single coverage and \$29,100 for non-single (e.g., family) coverage.ⁱⁱ Though plans will be taxed, economists expect employers to pass the cost along to employees.

[Economists generally believe that raising the price of health insurance would reduce health expenditures](#), and possibly cost growth, by reducing demand for services and increasing demand for greater efficiency in benefit design and health care services. The Cadillac plan tax is a blunt cost-control instrument facing much criticism for being unfair. For thing, plans may be high-cost, not due to inefficiency, but because they happen to cover people living in high-cost areas or cover a disproportionate share of sick people. Also, when employers distribute the cost of the excise tax to employees, they may, or may not, choose to do this in a way that favors higher wage workers who generally have the most decision-making power within a business.

Proposal 1: Begin taxing employees on a relatively small percentage of the value of job-provided health benefits. Option: low-income employees could be held harmless.

Instead of an open-ended exemption, an employee's tax rate could be applied to a portion (say 10%) of the value of employer-provided health benefits. So, \$500 of coverage worth \$5,000 would be taxed. This approach would send a price signal across the entire workplace health coverage system rather than just to high-cost plan outliers. Until recently, estimating the value of coverage would have been difficult, particularly for self-funded plans. But the ACA now requires employers to determine the value of health benefits. (Under this proposal, benefits for dependent children could be entirely excluded from taxation or taxed at an even lower rate.)

It would be important that all workers see on their pay statements the value of their health benefits as part of their compensation along with the amount of tax they owe on it. Such transparency could help employees understand financial impacts as their employers consider changes to benefit plans. Legislation could be designed to allow employees at the bottom of the wage distribution to receive refunds equal to the tax they paid (or even small tax credits to help them afford coverage). In this way, everyone would see an additional price signal via modest benefit taxation, but those in most need could be held harmless of impacts that could impede them from paying for higher premiums or cost sharing.

For the price signal to help bend the cost curve, it's important that middle-income and high-income people actually pay the tax. This is arguably the section of the population whose demand for services shapes the national expectation of what is a socially acceptable health benefit package. Changing the economic calculus of better-off people is key to long-run health care cost-control. Ironically, policymakers are much more likely to consider increased price signals or austerity measures for health insurance programs for the poor, such as increased cost sharing, low provider payment, or block grants with regard to Medicaid. It's unlikely that economizing on the benefit package for the poor would have spillover effects on middle class demand for benefits. In contrast, increasing price signals for the wealthy and middle class could have spillover effects that save money for Medicaid over time.

Raising the cost of health insurance has the negative effect of raising the number of uninsured, because some employers may decide to not offer coverage and some employees may forego it

at higher costs. However, the availability of subsidized individual coverage through Medicaid and the exchanges has greatly mitigated this concern as implementation of the ACA continues.

Retirement Security and Long Term Care

Proposal 2: Shift currently disproportionate tax subsidies for employee retirement savings from high-wage workers to lower-wage workers, while creating a retirement savings and investment system that includes everyone.

[Under current law](#), in 2017 employees can put up to \$18,000 in tax-deferred defined contribution plans (e.g., 401(k)s) and those 50 or older can put aside an additional \$6,000. Total employee and employer contributions are limited to \$54,000.ⁱⁱⁱ Using a net present value method (taking into account future earnings and taxes), the [Tax Policy Center estimates](#) that in 2016 the tax savings from all tax-qualified pension and defined contribution accounts averaged about \$1,040 per taxpayer. (No kidding: 1040.) These tax savings, however, were extremely tilted toward the well-off.^{iv} Only 4.4 percent of workers in the lowest fifth of the income distribution received any tax benefit and their average tax savings in 2016 was \$20. In contrast, 82 percent of the highest-paid quintile received a tax benefits with an average benefit of \$4,750. About 48 percent of the middle fifth received a tax benefit with an average savings of \$580. The result of this tax policy? About half the American population has put aside virtually nothing for retirement, while wealthy people are being paid to save money they would have saved anyway. It's clear that retirement savings tax breaks could be better targeted.

The following changes would include everyone in the retirement savings system and distribute tax savings more fairly: First every worker would receive a \$500 annual contribution (prorated for less than full-time work) from the federal government, minus income and payroll taxes, within an individual core account similar to a Roth IRA. To prevent “leakage,” government contributions to the core accounts, and earnings they generate, could only be used for risks of old age, including retirement income and long term care premiums or the cost of long term care.

Under this proposal, employer contributions to DC plans would continue to be tax deductible for the employer. Only the first \$5,000 of contributions would be entirely tax exempt for employees as now. Contributions of greater than \$5,000 would be taxed progressively with a reduced tax advantage. One approach would be to tax these additional contributions at a rate equal to the taxpayer's highest tax bracket minus 10 percentage points. Thus, workers in the 10 percent tax bracket would pay no tax. People hitting the 35 percent tax bracket would pay 25% in taxes on funds greater than \$5,000 put in a DC plan; funds being taxed in this way could either be withdrawn tax-free as with a Roth, or a small tax rate could be applied – say five percent. The new taxes could be used to fund the annual \$500 core account contributions that everyone gets. If enough revenue is generated, core accounts could be set up when a person receives a Social Security card and be seeded with an initial contribution of \$100 to \$500.

Positive impacts: Everyone would have retirement savings and middle- to lower-income people would have more retirement security and ability to deal with the risk of needing long term care late in life. Over 40 years, for example, the automatic annual contribution of \$500 alone would result in about \$67,000, if invested at a five percent real rate of return. Annuitizing that amount could significantly increase the income of those dependent on Social Security. Or it could cover almost a year of care in a nursing home. The universality of the system could increase the retirement savings rate for lower-income people. Because everyone would have a core account run by a fiduciary, everyone would have a place to add retirement savings and advice about best investment options.

Negative impacts: Setting up accounts for everyone and taxing contributions over \$5,000 modestly would be more complex than today. But these issues are entirely manageable with today's tax preparation software. For example, taxes could be drawn from accounts when people filed their returns.

The core accounts would improve retirement readiness for many people, particularly those in the bottom half of the income distribution. Most of the cost of the \$500 contributions would be borne by the top quintile, but it would be a relatively modest increase. Removing the entire current tax break for pensions and DC contributions would increase the effective tax rate for the highest-income quintile by only 1.5 percentage points, according the Tax Policy Center. The change in effective tax rate proposed here would be considerably less than that – with some tax advantage left for the wealthiest. [There is currently a debate about whether, to what degree, tax breaks incentivize increased private savings](#) for those with disposable income,^v which strengthens the case for getting rid of them altogether. But for people who have trouble making ends meet, taking the further steps of organizing an account and putting some money in it would probably increase long-term savings.

Of course, Congress could decide to fund modest universal contributions to DC accounts without squeezing savings out of the current tax exclusion. That is: pull the money from somewhere else.

Reshaping tax breaks in these two ways could improve long-run access to health care and long term care, and financial security for millions of Americans. Politically, of course, changing our tax rules is like running an electrified gauntlet. [In a recent column, George Will](#) lays out a strong case for limiting the deductibility of home mortgages because, in the long run, it does little to help anyone except the wealthy increase their wealth.^{vi} But he also offers this warning: “Attempting comprehensive tax reform is like trying to tug many bones from the clamped jaws of many mastiffs. Every provision of the code — now approaching 4 million words — was put there to placate a clamorous faction, or to create a grateful group that will fund its congressional defenders.”

ⁱ “Winners and Losers from Trump’s New Tax Plan,” Fiscal Times, downloaded from web April 27, 2016. <http://www.msn.com/en-us/news/politics/winners-and-losers-from-trump%e2%80%99s-new-tax-plan/ar-BBApEWK>

ⁱⁱ “The Excise Tax on High-Cost Employer Sponsored Health Insurance: Estimated Economic and Market Effects,” Jane G. Gravelle, Senior Specialist in Economic Policy, Congressional Research Service, January 12, 2017. <https://fas.org/sgp/crs/misc/R44159.pdf>

ⁱⁱⁱ Retirement Plan Contribution and Benefit Limits, Pension Rights Center. <http://www.pensionrights.org/publications/fact-sheet/retirement-plan-contribution-and-benefit-limits>

^{iv} Tax Benefit of Certain Retirement Savings Incentives (Present-Value Approach) by Expanded Cash Income Percentile, 2016, Tax Policy Center. <http://www.taxpolicycenter.org/model-estimates/individual-income-tax-expenditures-july-2016/t16-0161-tax-benefit-certain-retirement>

^v Increasing Retirement Saving: Reforming Tax Incentives and an All-of-the-Above Approach, David Kamin, Aspen Institute, Feb. 28, 2017. <https://www.aspeninstitute.org/blog-posts/increasing-retirement-saving-reforming-tax-incentives-approach/>

^{vi} “One tax change that should be made — and certainly won’t be,” George Will, Washington Post, April 28, 2017. https://www.washingtonpost.com/opinions/one-tax-change-that-should-be-made--and-certainly-wont/2017/04/28/1f8fcac2-2b82-11e7-b605-33413c691853_story.html?tid=ss_tu&utm_term=.4694b6bfca0d