

Less Costly Health Insurance Through Section 125 Plans

Presented to the:

Small Business Commission

October 21, 2008

**Stephen W. Bowman
Senior Staff Attorney/Methodologist
Joint Commission on Health Care**

Agenda

- Health Insurance Background
- Section 125 Plans
- Policy Options

Organizations Contacted

- Agency for Healthcare Research and Quality
- Anthem
- Asset Protection Group, Inc.
- BB&T Insurance Services, Inc.
- Benefit Solutions Inc.
- Connecticut Business and Industry Association
- Connecticut General Assembly Office of Legislative Research
- Independent Insurance Agents of Virginia
- Internal Revenue Service
- Iowa Insurance Division
- JLARC
- Maryland Health Care Commission
- Massachusetts Commonwealth Connector
- Massachusetts Joint Committee on Health Care Financing
- Minnesota Department of Health
- Missouri Joint Committee on Legislative Research
- National Conference of State Legislators
- National Federation of Independent Businesses
- Office of the Secretary for Health and Human Resources
- Rhode Island Office of the Health Insurance Commissioner
- Riverside Health System
- State Corporation Commission
- Total Administrative Services Corporation
- Virginia Association of Health Underwriters
- Virginia Attorney General's Office
- Virginia Commonwealth University
- Virginia Association of Health Plans
- Virginia Chamber of Commerce
- Virginia Department of Business Assistance
- Virginia Department of Health
- Virginia Department of Tax
- Virginia Employment Commission
- Virginia Farm Bureau
- Virginia Health Underwriters Association
- Virginia Local Commissioner's of Revenue
- Your Benefits Partner

Health Insurance Background

Health Insurance Affordability Is the Primary Barrier to Access

- Uninsured Estimates range from 9% - 15.5%
 - 632,000 – 1 million non-elderly Virginians
- “Affordability is the primary barrier to obtaining health insurance”
 - JLARC health insurance study finding

Employers Have Been a Primary Source of Working Non-Elderly Obtaining Health Insurance

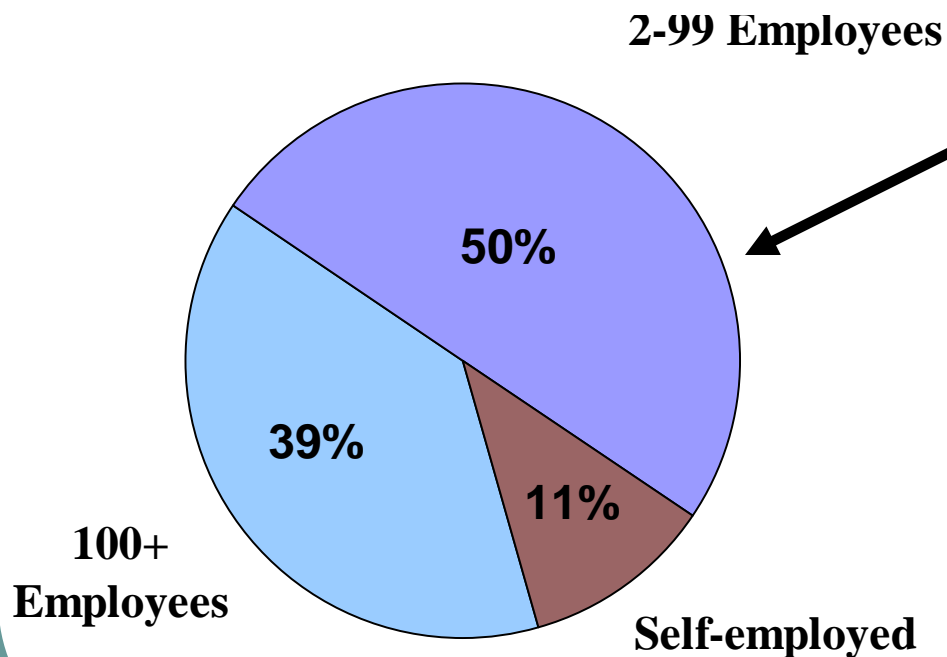
60% of firms offered health insurance in 2006; down from 69% in 2000

- Approximately 77% of covered employees pay 0% - 50% of premium costs (2006)
- Virginia health insurers often require significant employer contribution for small group plans
 - frequently 50% of premium

# Employees	% Offering Health Benefits (2006)
3 to 9	45%
10 to 24	76%
25 to 49	83%
50 to 199	94%
200 or more	99%
All Firms	60%

50% of Working Uninsured Households Have Someone Employed in a Small Business

Employment Sources for At Least One Person in a Working Uninsured Household

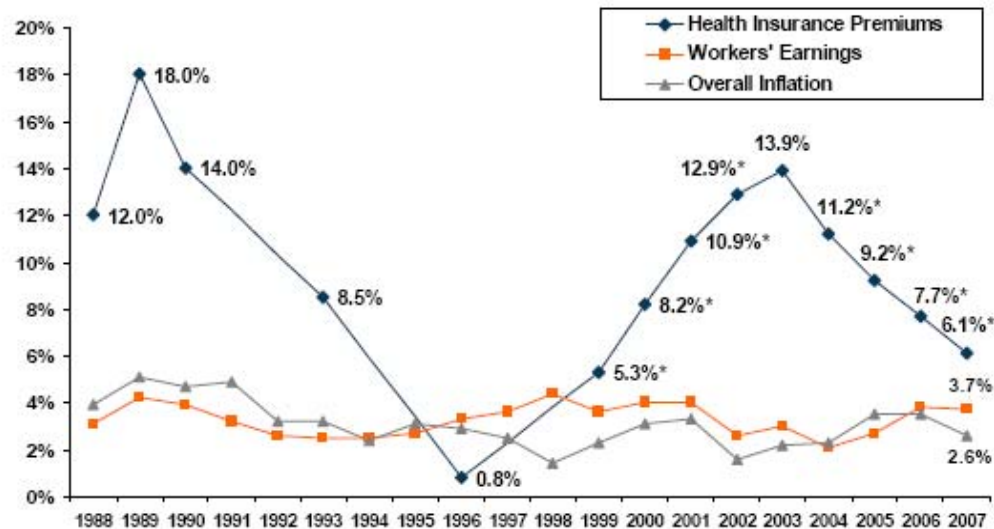


Uninsured employees that work in smaller businesses (2-99 employees) account for 50% of Virginia's working uninsured

Note: Only 48% of small employers (2-50) offer health insurance to their employees

Health Insurance Premiums Continue to Increase

Exhibit 1: Increases in Health Insurance Premiums Compared to Other Indicators, 1988-2007



*Estimate is statistically different from estimate for the previous year shown ($p < .05$). No statistical tests are conducted for years prior to 1999.

Note: Data on premium increases reflect the cost of health insurance premiums for a family of four. The average premium increase is weighted by covered workers.

Source: Kaiser/HRET Survey of Employer-Sponsored Health Benefits, 1999-2007; KPMG Survey of Employer-Sponsored Health Benefits, 1993, 1996; The Health Insurance Association of America (HIAA), 1988, 1989, 1990; Bureau of Labor Statistics, Consumer Price Index, U.S. City Average of Annual Inflation (April to April), 1988-2007; Bureau of Labor Statistics, Seasonally Adjusted Data from the Current Employment Statistics Survey, 1988-2007 (April to April).



- Premiums are rising at a slowing rate
- Rate of increase is still greater than workers' earning increases

Sources: Kaiser Family Foundation and Health Research Educational Trust, *Employer Health Benefits* (2007) Catlin, et al., *National Health Spending In 2005: The Slowdown Continues*, *Health Affairs* 26 (1): 142 (2007)

Background: Health Care Costs Study

- JCHC recommended in 2008 JCHC study the advisability of:
 - i) *increasing employer adoption of Section 125 plans,*
 - ii) establishing a Virginia health insurance exchange targeted for small businesses, and
 - iii) any other health insurance issues as deemed appropriate.

A blue horizontal bar with a rounded right end, containing the text "Section 125 Plans". The bar is framed by a dark green outline that forms a rectangular shape with rounded corners, extending above and below the bar.

Section 125 Plans

Section 125 Plans Defined

- Enables employees to purchase health insurance policies with pre-tax dollars
 - Refer to Section 125 of the U.S. Internal Revenue Code
 - Group Plans (with or without employer contribution)
- Employee savings can be 25%-40% per dollar contributed towards health insurance
 - FICA (Social Security and Medicare payroll tax), federal and state income taxes
- Employers can decrease tax liability by decreasing their payroll taxes, if employees contribute to their health care premiums

About Section 125 Plans

- Employers which do not offer health insurance are not benefited as there would be no reduction in payroll taxes paid
- Not all entities and individuals can participate including:
 - Self-employed individuals
 - Partners in a partnership
 - Outside directors, limited partners and members in Limited Liability Corporations (LLCs)

Section 125 Plans Are Not Helpful When

- Low-income employees do not make enough to afford health insurance
 - Less than 200% of the Federal Poverty Guideline
- Employers that pay 100% of the employees' premiums are not benefited by setting up a plan
 - No payroll tax for employers or employees to deduct from wages or salary

Types of Section 125 Plans

- Section 125 plans can address
 - Premium Only Plans (POP)
 - Flexible Spending Accounts (FSA)
 - Medical Expenses
 - Dependent Care Expenses
 - Full Flexible Benefit Plan with Benefit Credits

Focus of the Presentation is increasing employer adoption of Section 125 - Premium Only Plans

Section 125 Plan Requirements

- Plan must delineate:
 - Description of the benefits that may be elected
 - Eligibility rules
 - Method, timing and irrevocability of participant elections
 - Manner of any employer contribution
 - Maximum amount of employer and employee contributions under the plan
 - The Plan Year
- Plan must be adopted by employer

Section 125 Effect on Premium Cost: Employee Illustration # 1

Individual earning \$50,000 Annually (~\$24/hour) = 409% of Federal Poverty Guidelines

	Single
VA Small Group avg. monthly premium (2006)	\$ 246
<hr/>	
Payroll deduction amount (through 125 plan)	\$ 246
<hr/>	
Reduction in FICA tax \longrightarrow 7.65%	\$ 19
Reduction in federal tax liability \longrightarrow 18%	\$ 44
Reduction in VA state tax liability \longrightarrow 5.2%	\$ 13
<hr/>	
Net premium cost to employee (including after tax-savings)	\$ 170
<hr/>	
Total Monthly Tax Savings \longrightarrow 31%	\$ 76

Sources: Internal Revenue Service and Virginia Department of Taxation

Section 125 Effect on Premium Cost: Employee Illustration # 2

Married Worker with Two Children earning \$70,000 Annually
(~\$33.65/hour) = 339% of Federal Poverty Guidelines

			Family of 4
VA Small Group avg. monthly premium (2006)			\$ 645
<hr/>			
Payroll deduction amount (through 125 plan)			\$ 645
<hr/>			
Reduction in FICA tax	→ 7.65%		\$ 49
Reduction in federal tax liability	→ 15%		\$ 97
Reduction in VA state tax liability	→ 5.4%		\$ 35
<hr/>			
Net premium cost to employee (including after tax-savings)			\$ 464
<hr/>			
Total Monthly Tax Savings	→ 39%		\$ 181

Sources: Internal Revenue Service and Virginia Department of Taxation

Section 125 Effect on Premium Cost: Employee Illustration # 3

Married Worker with Two Children earning \$50,000 Annually
(~\$25/hour) = 235% of Federal Poverty Guidelines

		Family of 4
VA Small Group avg. monthly premium (2006)		\$ 645
Payroll deduction amount (through 125 plan)		\$ 645
Reduction in FICA tax	→ 7.65%	\$ 49
Reduction in federal tax liability	→ 13%	\$ 87
Reduction in VA state tax liability	→ 5.2%	\$ 33
Net premium cost to employee (including after tax-savings)		\$ 476
Total Monthly Tax Savings		\$ 169

Sources: Internal Revenue Service and Virginia Department of Taxation

Section 125 Effect on Premium Cost: Employer Illustration # 1

Small firm with 10 employees has an annual payroll cost of \$500,000

		§ 125 Plan w/o POP	§ 125 Plan w/ POP
Annual Payroll		\$ 500,000	\$ 500,000
Employee payroll deduction amounts (VA small group premium average (2006) – 5 single and 5 families of 4)		\$ 0	\$ 53,460
<hr/>			
Taxable Payroll	————→	\$ 500,000	\$ 446,540
<hr/>			
Annual Social Security Tax Rate	7.65%		
Annual Social Security Tax	————→	\$ 38,250	\$ 34,160

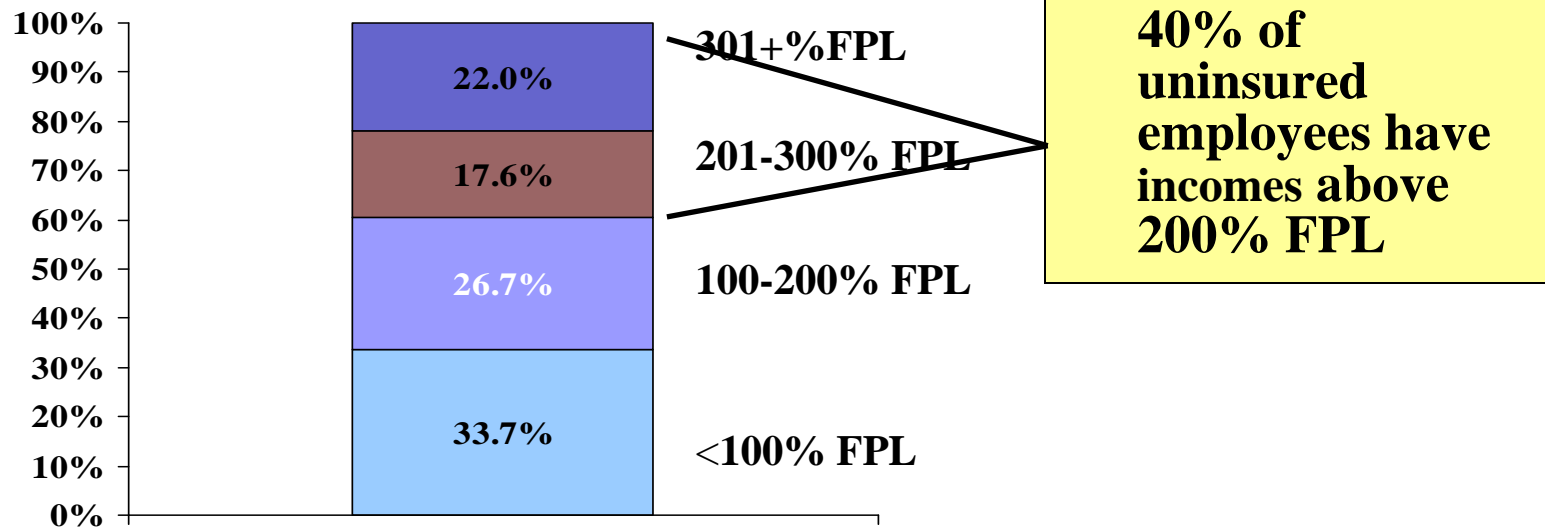
Employer Annual Tax Savings with Section 125 Plan **\$ 4,090**

Which Employees Would Be Affected?

- Employees that can afford and purchase health insurance policies can be assisted

Note: 200% FPL is a lower-end affordability threshold

Virginia Uninsured by Federal Poverty Level (FPL) (2005 & 2006)



Virginia Small Businesses Are Much Less Likely to Offer Pretax Savings

Employers Offering Health Coverage w/o Pretax Savings	# of Employees	
	Less than 50	50+
% of Employers	68%	8%
% of Employees Enrolled	52%	5%
	291,000 employees	139,000 employees

Note: If employer pays 100% of health insurance cost then there is no need for a Section 125 plan

Source: Unpublished estimates for Virginia provided by the Agency for Healthcare Research and Quality

Why Haven't More Businesses Adopted Section 125 Plans

- Employer lack of knowledge
- Perception of:
 - Significant increased administrative burden
 - Cost
 - Time it takes to learn and develop plans
- Not all business owners can receive pretax benefits toward their premiums
- Tax consequences if plan not correctly setup

Potential Benefits of 125 Plans

- Section 125 plans can be set up for as little as \$100
- Profits can increase for employers that offer health insurance
- Employee health insurance costs can be reduced
- Increased health insurance adoption can improve health of employer's workforce
- Many parties can assist in creation of plans:
 - Health insurance brokers
 - Health insurers
 - Third-party administrators
 - CPAs
 - Attorneys

Initiatives in Other States

- Massachusetts – requires employers with 11 or more employees to offer at least a “premium only” Section 125 plan
 - Tax consequence if the employer does not contribute a portion to employee health insurance
 - State created document detailing how to set up plan with sample form
- Rhode Island – requires use of Section 125 plans for employers with 25 or more employees
 - No requirement for employers to contribute to the plans

Initiatives in Other States

- Minnesota –employers affirm that they have read about Section 125 Plans or have a Section 125 Plan in place
- Iowa – Commissioner of Insurance required to assist small employers with implementing and administering Section 125 plans through information on website

Possible Avenues to Encourage Section 125 Plan Adoption

- Websites
 - Virginia Business Portal
 - Business One-Stop - Virginia Department of Business Assistance
 - Virginia Health Information (VHI)
 - InsureMoreVirginians - Department of Health
 - Bureau of Insurance – State Corporation Commission

- Agencies that can assist small businesses regarding health insurance
 - Department of Business Assistance
 - Bureau of Insurance
 - Department of Health

- Professionals that serve small businesses
 - Brokers
 - Insurers
 - Third-party administrators
 - CPAs
 - Attorneys

Methods to Increase the Adoption of Section 125 Plans

- Amend the *Code of Virginia* to mandate that employers offer a Section 125 Plan if all of the following provisions are met:
 - 11 or more full-time employees,
 - Group health insurance is offered, and
 - Employee pays some part of the health insurance premium
 - (*Option 2*)
- Provide Section 125 Plan information to employers on state website, information may include:
 - Brief document highlighting Section 125 Plan benefits
 - Detailed document with Section 125 Plan requirements and adoption details
 - Detailed document with Section 125 Plan requirements and adoption details with sample Section 125 Plan adoption forms
 - (*Options 3, 4 and 5*)

Methods to Increase the Adoption of Section 125 Plans (Continued)

- Amend the *Code of Virginia* to require employers with 11 or more full-time employees to affirm either:
 - Employer has read the state-created document regarding Section 125 Plans, or
 - Employer has a Section 125 Plan
 - (*Option 6*)
- Consider including Section 125 plan information on the State's health insurance broker examination.
 - (*Option 7*)

Methods to Increase the Adoption of Section 125 Plans (Continued)

- Work to increase adoption through awareness of Section 125 Plans through public-private partnership with:
 - Virginia Chamber of Commerce Newsletter
 - National Federation of Independent Businesses – Area Action Council meetings
 - (*Options 8 and 9*)

Policy Options

As submitted to the Joint Commission on Health Care

Policy Options

Option 1: Take no action

Option 2: Amend the *Code of Virginia* to mandate that employers offer a Section 125 Plan if all of the following provisions are met:

- 11 or more full-time employees,
- Group health insurance is offered, and
- Employee pays some part of the health insurance premium

Note: No requirement for employers to provide health insurance or contribute to plan premiums.

Policy Options

Option 3: Request by letter of the Chairman that the Department of Human Resources Management (DHRM) in consultation with the Department of Business Assistance (VDBA) create a:

- Brief electronic document that highlights Section 125 benefits to post on the VDBA website and on Virginia's business portal website.

Option 4: Request by letter of the Chairman that the Department of Human Resources Management in consultation with the Department of Business Assistance (VDBA) create a:

- Detailed electronic document that highlights Section 125 benefits; requirements for adoption; and COBRA, ERISA and HIPPA implications for posting on the VDBA website and on Virginia's business portal website.

Policy Options

Option 5: Request by letter of the Chairman that the Department of Human Resources Management in consultation with the Department of Business Assistance (VDBA) create a:

- Detailed electronic document that highlights Section 125 benefits; requirements for adoption; COBRA, ERISA, and HIPPA implications; and a simple Section 125 plan form for posting on the VDBA website and on Virginia's business portal website.

Option 6: Amend the *Code of Virginia* to require that employers affirm on the Virginia Department of Taxation Form VA-6 that:

- Employer has a Section 125 Plan, or
- Employer has read the State-created document regarding Section 125 Plans.

Policy Options

Option 7: Request by letter of the Chairman that the State Corporation Commission consider and report to JCHC on including Section 125 Plan information on both the Health and the Life & Annuity & Health insurance examinations.

Option 8: Request by letter of the Chairman that the Virginia Chamber of Commerce inform its membership of Section 125 Plans and associated benefits through its newsletter.

Policy Options

- **Option 9:** Request by letter of the Chairman that the National Federation of Independent Businesses/Virginia include Section 125 Plans as part of the Federation's Area Action Council meetings with small businesses.