F I S C A L   I M P A C T   R E P O R T

ORIGINAL DATE 1/26/09
SPONSOR Heaton **LAST UPDATED** 2/22/09 **HB** 109

SHORT TITLE Employer Pre-Tax Health Coverage Options **SB**

ANALYST Hanika-Ortiz

REVENUE (dollars in thousands)

Estimated Revenue						Recurring or Non-Rec	Fund Affected
FY09	**FY10**	**FY11**	**FY12**	**FY13**	**FY09-FY13**		
$0.0	($3,510.0)	($3,859.0)	($4,253.0)	(4,686.0)	(16,308.0)	Recurring	General Fund
$0.0	$1,174.0	$1,290.0	$1,422.0	$1,567.0	$5,453.0	Recurring	Local Governments

(Parenthesis ( ) Indicate Revenue Decreases)

Companion to HB 110 and HB 111

SOURCES OF INFORMATION
LFC Files

Responses Received From
General Services Department/Risk Management Division (GSD/RMD)
Human Services Department (HSD)
Health Policy Commission (HPC)
Department of Health (DOH)
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

House Bill 109 will require that all employers offer a pre-tax (IRS Section 125) health coverage option for employees that are not offered a health plan, whether the employer chooses to contribute to that plan or not. Federally recognized Indian nations, tribes and pueblos acting as employers are exempt.

FISCAL IMPLICATIONS

Offering pre-tax health coverage will affect the amount of personal income tax, premiums tax and gross receipts tax revenues collected by the state.

To estimate various revenue impacts, TRD assumes employed uninsured individuals and employed individuals currently purchasing private insurance will take advantage of the pre-tax health coverage option. Information regarding medical expenditures was obtained from a 2007 TRD report. To project 2007 expenditure levels to future years, expenditures are assumed to rise at 8.4% annually. The level of health care expenditures (premiums and out-of-pocket expenses) for all individuals affected by the proposal is a weighted average of these amounts for each of three scenarios: uninsured, private insurance purchased pre-tax and private insurance purchased after-tax. These values are then used to estimate the per-employee revenue effect of offering pre-tax health coverage.

Employer-paid FICA taxes decline due to the pre-tax treatment of medical expenses. Wages are increased by an amount equal to the decline in employer FICA expenses. State personal income tax revenues decrease due to the pre-tax premium and out-of-pocket expenses, but increase due to increased wages; the change in personal income tax revenues is the product of an average marginal tax rate of 4.6% and the taxable compensation.

The pre-tax treatment of premiums also increases revenues collected through the premiums tax. For individuals' currently purchasing private insurance, the revenue effect is estimated as the product of a premiums tax rate of 4.003% and the difference between the premium amount when health coverage is purchased pre-tax and the lower premium amount when health coverage is purchased after-tax. For uninsured individuals, the revenue effect is estimated as the product of a premiums tax rate of 4.003% and the pre-tax premium amount.

The effect on gross receipts tax revenues is estimated using a tax rate of 7.07%; 3.775% reflects the state portion and the remaining 3.295% reflects the local portion. The gross receipts tax rate of 7.07% is multiplied by the increase in disposable (after-tax) income spent on taxable items.

Conversion from per-employee revenue effects to overall state and local revenue effects requires estimates of the number of employees currently purchasing private insurance, the number of employees who are currently uninsured and an estimate of how many in each group will use the Section 125 plan. A 2007 Mathematic report indicates that 2% of New Mexicans purchase individual private insurance. Applying this percentage to employment figures obtained from the Bureau of Business and Economic Research (BBER) indicates that approximately 16,000 employees currently purchase private insurance. It is assumed that all of these employees would use the Section 125 plan, and spend an additional 20% on premiums.

The 2001 Medical Expenditure Panel Survey indicates that 20% of employees are uninsured because they are not offered insurance by their employer. Multiplying 20% by the number of non-agricultural employees suggests that more than 160,000 employees are not offered health coverage by their employer. However, some of these individuals (an assumed 7%) opt to purchase private insurance, leaving approximately 105,000 uninsured, of which 1% (1,050) are assumed to take advantage of the pre-tax health coverage. Projected annual growth rates in employment (obtained from BBER) are used to project these numbers to future years.

TRD provided the following table detailing the various components of its revenue estimate.

Detailed Estimated Revenue Impact*						
	FY09	**FY10**	**FY11**	**FY12**	**FY13**	**FY09-FY13**
State Income Tax (General Fund)	-	(5,395)	(5,931)	(6,538)	(7,203)	(25,067)
Premiums Tax (General Fund)	-	541	594	655	722	2,512
Gross Receipts Tax (General Fund)	-	1,345	1,478	1,629	1,795	6,248
Subtotal, Change in State Taxes	-	(3,510)	(3,859)	(4,253)	(4,686)	(16,308)
Gross Receipts Tax (Local Governments)	-	1,174	1,290	1,422	1,567	5,453
Total Change in State and Local Taxes	-	(2,336)	(2,568)	(2,831)	(3,119)	(10,855)

* In thousands of dollars. Parentheses ( ) indicate a revenue loss.

SIGNIFICANT ISSUES

HB 109 may allow more people to have access to health insurance, reduce the cost of health insurance for some employees choosing to purchase privately and may help decrease the amount of individuals and families left uninsured in New Mexico. HB 109 is part of Governor Richardson's 2009 Health Care Reform legislative package.

An IRS Section 125 cafeteria plan benefits employers because they do not pay Medicare, Social Security, or Unemployment Insurance taxes on the amounts that employees have withheld from their paychecks on a pre-tax basis. Employees also benefit from the ability to pay for health insurance coverage with pre-tax earnings. Depending on their income, the cost of health insurance for an individual, their spouse and family, can be significantly less. In some cases, an IRS Section 125 plan can increase the amount of take-home pay for the employee.

PERFORMANCE IMPLICATIONS

Implicit in this bill is the employer's obligation to timely obtain approval for the plan which qualifies under IRS Section 125. This raises the question of what is the employer required to do if the cafeteria plan is not approved by the IRS.

The bill does not define the words "employer" or "employee". GSD/RMD reports that the definitions applicable to IRS section 125 will most likely apply.

COMPANIONSHIP

Companion to HB 110; Health Insurance Guaranteed Issue
Companion to HB 111; Health Insurer Direct Services Reimbursement

OTHER SUBSTANTIVE ISSUES

According to a study by Research & Polling, Inc. commissioned by GSD and HSD in 2007, 69 percent of New Mexico vendors offered health insurance to their employees. Cost was the primary barrier to New Mexico vendors that did not offer health insurance to their employees.

HPC states that from 2005 to 2007, 21.9 percent of New Mexicans did not have health insurance. New Mexico had the second highest rate of people without health insurance in the nation. Among uninsured adults in New Mexico, 25 percent work one part-time job, and 41 percent work multiple part-time jobs. The largest percent of the uninsured are between the ages of 18 to 34.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

Employers will not be required to offer employees a pre-tax health coverage option for their employees.

AHO/svb:mc