Taxing Employer Sponsored Health and Dental Benefits Plans

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Executive Summary

The current tax treatment of employer sponsored health and dental benefits plans is achieving important, broad-based public benefits in a way that fully meets the objectives of effectiveness, fairness and efficiency for individual Canadians, small and large employers, and the overall delivery of health care services. When considering these benefits in the context of a comprehensive review of federal tax expenditures, it is important to think beyond tax policy and consider the role that these benefits play in supporting the health of Canadians and in augmenting services provided by our public health systems.

The current tax incentives to employers to offer health benefits to their employees are highly effective. Canadians value this employment benefit and enjoy better healthcare as a result. The estimated $2.7B[1] in tax incentives is generating $23B[2] in health care funded through employer health and dental benefits plans. Low and medium wage employees and small firms are the biggest beneficiaries. These health benefits are keeping Canadians healthier, more productive, and out of hospitals and doctor's offices.

The 1993 Quebec precedent shows that taxing these benefits will lead to a substantial loss of coverage.[3] This is valuable health care not normally covered by provincial health care plans. Provincial health systems would come under significant new pressure to address unmet health needs.

The current tax expenditure related to employer sponsored health and dental benefits meets the expectations for effectiveness, fairness and efficiency in support of important public interests, and should be preserved in its current form. Any changes to the current policy is certain to result in fewer Canadians having access to health care funded through these benefits.

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[1] Conference Board of Canada, The Implications of Taxing Employer-Paid Health and Dental Benefits, 2017 Unpublished

[2] CLHIA 2016 Fact Sheet

[3] Finklestein, A. The effect of tax subsidies to employer provided supplementary health insurance. Journal of Public Economics 84 (2002) 305-339.

Policy Rationale

There is a clear public interest that is being achieved by encouraging employers to provide benefits to their employees.

These benefits are helping 22 million Canadians[4] access health care that is not normally provided through provincial and territorial health care systems. This includes prescription drugs, mental health services, treatment of back pain and other musculoskeletal conditions, dental and vision care, nutrition services and other preventive health care. Only health care that is recognized by the Canada Revenue Agency can be funded through eligible employer sponsored benefits.

The $2.7B in tax expenditure incents more than $23B in annual health care delivered through employer health and dental benefits plans. This is a major portion of private health expenditure in Canada, which is about 30% of total health expenditures.[5] At a time when there are concerns about how to sustain the long-term investment in the public health care system, and when less rather than more services are made available through the public system, maintaining this employer commitment through employer health and dental benefits plans is essential to the health and wellbeing of the Canadian workforce and their families.

Canada's health care system is a shared public-private responsibility, and this approach has demonstrated many benefits in providing Canadians with a patient-centered approach to timely and appropriate high quality care. In particular, health care provided through employer health and dental benefits plans complements the focus of the public system by helping Canadians to have access to a wider range of health needed services to better meet their unique health goals, access affordable prescription drugs, and support better integration of wellness and disease prevention. It is important this health care be available because of the important role of complementary therapies, disease prevention and health promotion to help the public system to improve health outcomes and lower costs. The approach is "more investment upstream now to contain downstream expenses in the future."[6] At the same time, there is recognition that these kinds of health services are not economically feasible for the public system.

Without the current tax treatment of employer health and dental benefits plans, there would be a sharp reduction in coverage. When benefits were subject to provincial income tax in Quebec in 1993, almost 20% of employers, including up to 50% of small employers, stopped offering health benefits.[7] Others may have lessened coverage. Subjecting these benefits to both federal and provincial income taxes across the country will lead to an even greater loss of coverage, including from national firms that made an exception for Quebec employees.

The leading reason employers provide benefits is to maintain productivity by protecting health.[8] A well designed physical and mental wellness and health promotion program can extend the benefits of an

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[4] CLHIA 2016 Fact Book

[5] CIHI, National Expenditure Trends, 1975 to 2016

[6] Canadian Public Health Association, *A Fine Balance: A Public Health Perspective on Health System Reform*. April, 2002.

[7] Finklestein, A. ibid.

[8] Sanofi Canada Health Care Survey, 2016

employer health and dental benefits plan by returning as much as three dollars for every dollar invested.[9]

The investment by employers in the health of their employees also directly benefits the public health care system. Without the health care covered by benefits, Canadians will enter the public system with greater health needs, driving up costs to provincial governments. For example, a 40% reduction in benefits coverage (employers cancelling or reducing coverage) would total a $9.2B reduction in private spending. The Quebec example found that 10% of those losing coverage would purchase privately, leaving $8.2B in new pressure on provincial health care systems which may result in either new pressures to spend more on provincial health care or unmet health care needs.

Preserving current tax treatment also avoids economic impacts. The availability of health benefits is a major determinant of the decision to seek care for many Canadians, and reduced coverage will therefore also reduce economic activity by the many health providers outside the public system. As well, reductions in the current $39.9B in premium revenue by Canadian insurers[10] are likely to result in a substantial reduction of economic activity in that sector.

The government's plans are grounded in the understanding that a healthy economy starts with a strong and growing middle class. Employers join the government in this objective with the understanding that a healthy workforce is also essential to a healthy economy. The encouragement to employers to offer health benefits is beneficial, and an investment in the middle class and those working hard to join it.

Effectiveness

The key indicator of effectiveness of the current tax treatment of employer health and dental benefits plans is that the $2.7B tax expenditure incents $23B in health care being provided to 75% of working Canadians and their families (a total of 22 million Canadians).[11]

The Quebec example discussed above demonstrates the high level of sensitivity of employers to the tax status of benefits in determining whether to maintain coverage. In Quebec, subjecting employer health and dental benefits plans to the provincial portion only of income taxes resulted in almost 20% of all employers, and almost 50% of small employers, to end coverage. Adding the federal portion of income taxes, and motivating national employers who were willing to tolerate a Quebec exception to reevaluate their benefit plans, will likely result in a much higher loss of coverage. As a result, the current tax status of these plans is highly effective in incenting employers to provide them.

The broad participation in employer health and dental benefits plans, specifically the incentive for younger and healthier Canadians to participate in employer plans, maintains a health risk pool that keeps costs down for all participants, and makes it easier for employers to maintain their plans. According to a recent IPSOS poll, 48% said they would prefer to take cash over health benefits if they

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[9] CLHIA Report on Health Care Policy, Toward a Sustainable, Accessible, Quality Public Health Care System, June 2009

[10] CLHIA 2016 Fact Book

[11] CLHIA 2016 Fact Book

were taxed at the same rate.[12] Conversely, taxing these benefits is expected to motivate many younger and healthier Canadians to drop their coverage, eroding the pooling effect and compounding the loss of coverage.

Employer health and dental benefits plans are a highly cost-effective approach to delivering access to care. This is particularly true for older Canadians, or those with pre-existing conditions. Canadians who lose access to benefits through their employer will face much higher costs accessing the same level of coverage through individual coverage, and are likely to also face caps and other limits that group plans do not apply. As a result, in Quebec only 10% of those who lost employer coverage subsequently obtained private coverage.[13]

It is likely that if employer health and dental benefits plans were taxed that the $2.7B available to the federal government would erode as employers and individual employees drop coverage.

Fairness

The current tax treatment of health benefits demonstrates a high level of fairness. Taking needed health care away from millions of Canadians is not the way to address fairness and equity.

Within firms that offer benefits, there is a high level of equity as most firms offer the same benefits to virtually all employees regardless of income. In many cases, permanent part time employees also have access to benefits.

CLHIA has estimated that 50% of employees earning $12 to $20 per hour ($25K to $40K per year) currently have the coverage from employer health benefits.

According to the Conference Board of Canada, the average annual premiums for family coverage for full time employees in 2016 was $3521.[14] More analysis is needed to determine the tax burden for lower paid employees with family coverage who are below the CPP maximum, recognizing as well that if benefit costs rise, the tax burden will increase even more.

Lower paid employees in firms that discontinue health and dental benefits plans will have the most trouble paying for drugs, dental services, and needed health care out of pocket, or buying a private benefit plan.

Smaller employers will face the greatest burdens in attempting to maintain coverage. The competitiveness of small employers requires being able to offer benefits, since 77% of employees would not move to a job that did not include benefits.[15] Yet already, smaller firms face a bigger relative administrative burden and higher costs to achieve the same level of coverage, and may be most impacted by a reduction in the number of enrollees, causing an additional rise in costs. This is particularly a risk for firms that have a significant number of employees below the CPP maximums, as

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[12] Ipsos, Omnibus Survey, December 2016
[13] Finklestein, A. ibid.
[14] Conference Board of Canada, The Implications of Taxing Employer-Paid Health and Dental Benefits, 2017 Unpublished
[15] Sanofi Canada Health Care Survey, 2016 p. 3

taxing employer health benefits will also trigger the requirements for CPP contributions on those amounts for employees earning below $55,000. This compounds the regressive impact of taxing employer health and dental benefits plans.

Taxing employer health and dental benefits also introduces an important new inequity into the system. Premiums for small employers and non-profits are significantly higher than large employers for the same level of coverage. As a result, those who work for small businesses and not-for-profits will have a greater tax burden than large employers, such as government and large corporations.

There are no reasonable alternatives to compensate for the impacts of taxing employer health benefits. For a number of reasons, the Medical Expense Tax Credit is an ineffective offset, particularly for the lowest income households that currently have access to health benefits. The METC is subject to an expensive threshold (lesser of 3% of net income or $2,237) that is a burden for low and medium income individuals. As well, the METC covers a much smaller proportion of care costs, and the delay between the expenditure and receiving the tax credit is likely to disincentive seeking care. Even with these negative implications, introducing a refundable tax credit would likely cost more to the treasury than the savings from taxing health benefits.[16]

Efficiency

The current tax treatment of health benefits demonstrates a high level of efficiency. Each dollar of current tax expenditure ($2.7B) is incenting $8.5 ($23B) in spending on health care that is not normally available through provincial/territorial health care systems. In addition, this benefit is available to 75% of working Canadians and their families (total of 22 million Canadians).

Obtaining the same level of coverage outside of employer and dental benefits health plans is far more expensive, particularly for older Canadians or those with pre-existing conditions. The taxation of employer health benefits is likely to negatively affect the risk pool for these benefit plans, as described above, driving up costs for the same level of coverage.

It is also likely that the public sector would have higher costs to deliver needed health care that is currently being accessed through employer health benefits.

While estimates are hard to provide, it is likely that the $2.7B in tax expenditure could not be accessed as coverage sharply drops as a result of taxing these benefits.

[16] Report of the Advisory Committee on Healthcare Innovation