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The Voice of Small Business.

Differences in tax treatment should not determine whether a person secures health insurance in the workplace or on their own. The current tax treatment of insurance premiums disproportionately tips the scale in favor of employer-based coverage. This tax inequity reflects an ad hoc reaction to World War II-era price controls.

Healthcare Solutions: Tax Parity for Insurance

Tax laws favor group over individual health insurance.

Tax laws have hobbled health insurance markets for decades. Since just after World War II, our tax laws have riddled the health insurance market with inefficiencies. Employees can purchase group health insurance with pre-tax dollars. But if employees or self-employed individuals purchase policies in the individual market, they lose some or all of these tax benefits.

This bias distorts health insurance markets.

This tax distortion, not economic efficiency, artificially herds businesses and workers into employer-sponsored insurance (ESI). As a result, small employers and employees typically have few choices.

The bias creates many serious problems.

This bias causes or contributes to some of the biggest problems in health-care. Many of the biggest complaints about health insurance derive from this tax bias toward group insurance.

This distortion limits competition and consumer control.

Thanks to this tax distortion and some related factor, the individual health insurance market is small and relatively uncompetitive. Employees with group insurance have little or no motive to compare policies and to shift their purchases toward policies that best fit their families' wishes. With employees unable to shop around, insurers have less of a motive to provide the insurance people want at prices they can afford.

The tax bias diminishes portability.

The employer/insurance nexus leads to "job lock." With today's group policies, employees can't carry their insurance from one employer to another. They can lose coverage altogether if they become unemployed. Or they face high costs of extending group coverage through the COBRA law.

It diverts small businesses from their core business.

To compete for labor, many employers must offer group insurance coverage. This requires the business owners to choose their employees' policies and to administer the plans. Most small business owners have no special expertise in health insurance. Assuming this role occupies their time and diverts them from building their businesses.

There should be tax parity for different purchasers.

This problem is solvable. These pathologies can be eliminated by treating all purchases of health insurance – group, self-employed, and individual the same under tax laws. This would allow economic efficiency to determine how and where Americans buy insurance.

This document is not advocating any particular version of tax parity.

Various versions of tax parity have been proposed, and this document is not advocating any particular version. Some would allow all insurance purchasers – group, self-employed, or individual -- to pay their premiums with pre-tax dollars. Other proposals would eliminate the tax exclusion altogether and replace it with a tax credit that all Americans could use to buy insurance.

Group insurance became the norm thanks to WWII wage-price controls.

The tax bias is a World War II-era accident. During and immediately after World War II, the federal government imposed wage and price controls. There were limits on when or whether employers could give their employees raises. Employers realized that giving benefits, such as health insurance, would not violate the restrictions on wage increases.

The bias was augmented by later laws and regulations.

As ESI became more common, tax law changes reinforced it by allowing employees to exclude group insurance premiums from their taxable income. The law did not extend this exclusion to individually-purchased insurance. Later on, labor regulations added health insurance to collective bargaining arrangements, further cementing the bias toward ESI.

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