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Report to Congressional Committees

August 1989

FEDERAL COMPENSATION

Premium Taxes Paid by the Health Benefits Program

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GAO

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General Government Division

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The Honorable William D. Ford
Chairman, Committee on Post Office
and Civil Service
House of Representatives

The Honorable Gary L. Ackerman
Chairman, Subcommittee on Compensation
and Employee Benefits
Committee on Post Office and
Civil Service
House of Representatives

At your request, we are reviewing certain aspects of the Federal Employees Health Benefits Program, including the administrative expenses of the program. On March 22, 1989, we briefed the committees on the results of our work to date. As requested, this report provides additional information on the premium taxes imposed by state and other governmental entities on insurance underwriters that service the participating plans in the health benefits program. Premium taxes are imposed to raise general revenues to fund various government programs. You asked us to provide information on the amount of premium taxes paid by each plan and the amount collected by governmental entities imposing the taxes.

Background

Premium taxes are imposed by states, county and municipal governments, U.S. territories, and the Republic of Panama on the portion of premium income paid to insurance underwriters by participating plans. Most fee-for-service plans[1] that participate in the program use insurance underwriters to process and pay claims from the premium income. Under federal procurement regulations, premium taxes are an allowable expense chargeable to the health insurance program.

Results in Brief

In 1987, 22 of 25 participating fee-for-service plans charged the health benefits program about $44 million for premium taxes imposed by the 50 states and other entities, including the District of Columbia and the Republic of Panama. These taxes are included in the plans' premiums charged to enrollees and the federal government. In 1980, Congress

[1] Fee-for-service plans are ones in which the enrollee chooses the health care provider and the plan reimburses the enrollee or provider for services rendered.

exempted Federal Employees Group Life Insurance Program premiums from similar premium-based taxes because Congress considered the program to be self-insured and, because states generally do not tax self-insured programs. Since the health benefits program operates in a similar fashion, Congress may want to consider exempting the health insurance program from premium taxes as well.

Objectives, Scope, and Methodology

To determine the amount of premium taxes charged to the program, we reviewed the 1987 annual accounting statements filed with the program administrator, the Office of Personnel Management (OPM), by the 25 fee-for-service plans participating in the program. We also used information in the accounting statements to determine which governments were receiving the premium taxes. Where we could not find this information in the statements, we obtained it from plan underwriters. We did not verify the accuracy of the premium tax amounts reported on the accounting statements. Also, these charges are subject to OPM's adjustment and audit.

Additionally, we reviewed applicable laws and regulations and interviewed responsible officials at OPM's headquarters in Washington, D.C. We did our work between September 1988 and May 1989 in accordance with generally accepted government auditing standards.

Premium Tax Charges

In 1987, 22 fee-for-service plans charged the health benefits program $44.1 million for premium taxes. The amount of premium taxes that each plan charged is shown in appendix I. Three of the 25 fee-for-service plans did not pay premium taxes because they did not use insurance underwriters. These plans were the Government Employees Hospital Association, the National Association of Letter Carriers, and the American Postal Workers Union. Some plans limit premium tax liability by limiting the premium income paid to their underwriters. The Blue Cross and Blue Shield (BC/BS) plan does not pay premium taxes to many states, including California and New York, because, according to BC/BS officials, these states have exempted the local BC/BS plans from taxes on premium income.

Appendix II shows that for 1987, premium taxes were paid to all 50 states, the District of Columbia, other governmental entities, and the Republic of Panama. Twelve plans did not specify the governmental entities to which they paid small amounts of taxes totaling about

$105,000. The Panama Canal Area Benefit plan charged the health benefits program $1.4 million for premium taxes paid to the Republic of Panama.

If the health benefits program had been exempt in 1987 from premium taxes imposed by states and county and municipal governments, we estimate that the government's contribution to premiums would have been about $28 million less. Likewise, program enrollees' premiums would have been $14 million less.

Federal Life Insurance Program Premiums Are Exempt From Tax

Before 1981, the Federal Employees Group Life Insurance Program reimbursed its underwriter for taxes paid on the premiums received by the underwriter. The Omnibus Reconciliation Act of 1980 amended the program's authorizing legislation to expressly prohibit states, the District of Columbia, the Commonwealth of Puerto Rico, or other political subdivisions from imposing or collecting taxes, fees, or other monetary payments based on premiums paid under the life insurance program (94 Stat. 2607). Congress changed this because it considered the program self-insured (the underwriter assumed no risk) and because states generally do not impose premium taxes on self-insured programs.

The Health Benefits Program Operates as If It Were a Self-Insured Program

The health benefits program operates as if it were self-insured because the risk of loss to fee-for-service plans is minimal. Plans with cumulative operational gains (premiums exceed claims and expenses) adjust premiums downward, increase benefits, or refund or suspend premium payments to reduce the gains. Plans with cumulative operational losses adjust premiums upward to recoup the losses. The plans receive a separately negotiated profit for administering the program regardless of whether there were operating gains or losses in any particular year. Plans in a deficit position would be liable for existing losses if they left the program while in a loss position. OPM officials, however, could recall only one fee-for-service plan which terminated in a loss position over the 30-year history of the health benefits program. This plan incurred a $61,000 loss. Plans leaving the program in a surplus position are required to return the excess funds to the program to be distributed among the remaining plans.

Plans in a deficit position also would be at risk if Congress restructured or terminated the health benefits program and eliminated the current plans. However, we believe that it is unlikely that Congress would hold plans liable for any deficits that were coincidental to such actions. It seems more likely that Congress would use the surplus funds from other plans to reimburse plans in a deficit position. As of September 30, 1988, the program overall had a net surplus of about $612 million.

Matter for Congressional Consideration

If Congress wants to make the treatment of premium taxes uniform in the health and life insurance programs, it may wish to consider amending the Federal Employees Health Benefits Act to expressly prohibit states, the District of Columbia, the Commonwealth of Puerto Rico, or other political subdivisions from imposing or collecting taxes, fees, or other monetary payments based on the premiums paid under the Federal Employees Health Benefits Program.

Agency Views

We discussed exempting the federal health insurance premiums from taxation with responsible OPM program officials. They said that OPM does not have a position at this time as to whether the federal health benefits program should be exempt from premium taxes.

As arranged with the Committee and Subcommittee, we are sending copies of this report to the Director, OPM, and other interested parties.

The major contributors to this report are listed in appendix III. If there are any questions concerning the contents of this report, please call me on 275-5074.

Bernard L. Ungar

Bernard L. Ungar
Director, Federal Human Resource
Management Issues

Premium Taxes Charged to the Federal Employees Health Benefits Program, by Plan (1987)

Plan	Premium income	Premium taxes	Percent of premium income
Blue Cross and Blue Shield	$2,773,295,941	$4,729,246	0.2%
Mail Handlers	812,884,441	17,503,965	2.2
Government Employees Hospital Association	620,258,647	0	0.0
Aetna	563,186,033	10,670,336	1.9
National Association of Letter Carriers	494,429,580	0	0.0
American Postal Workers Union	190,650,961	0	0.0
Postal Supervisors	170,138,038	3,556,930	2.1
Rural Carriers	110,243,859	2,277,777	2.1
National League of Postmasters	81,154,274	232,790	0.3
Alliance	67,045,814	1,406,388	2.1
Special Agents Mutual Benefit Association	54,760,329	131,493	0.2
American Federation of Government Employees	54,742,274	93,966	0.2
National Association of Government Employees	45,015,691	336,235	0.7
National Association of Postmasters	42,116,125	191,175	0.5
National Federation of Federal Employees	34,731,024	696,321	2.0
Panama Canal Area	33,955,656	1,371,524	4.0
American Foreign Service	19,765,617	377,021	1.9
National Treasury Employees Union	18,332,986	411,290	2.2
Government Employees Benefit Association	8,501,763	11,278	0.1
American Foreign Service - Overseas	3,527,218	9,122	0.3
Federal Managers	2,374,526	52,166	2.2
Secret Service	2,085,274	212	0.0
Beneficial Association of Capitol Employees	1,561,847	37,955	2.4
National Association of Treasury Agents	668,757	19,674	2.9
Association of Civilian Technicians	120,260	2,665	2.2
Total	**$6,205,546,935**	**$44,119,529**	**0.7%**

Distribution of Premium Tax Charges by Government Entity (1987)

States	Amount
Alabama	$2,598,000
Alaska	465,000
Arizona	847,000
Arkansas	456,000
California	4,169,000
Colorado	633,000
Connecticut	479,000
Delaware	72,000
Florida	2,026,000
Georgia	1,756,000
Hawaii	99,000
Idaho	350,000
Illinois	410,000
Indiana	616,000
Iowa	453,000
Kansas	370,000
Kentucky	606,000
Louisiana	641,000
Maine	303,000
Maryland	1,579,000
Massachusetts	499,000
Michigan	550,000
Minnesota	297,000
Mississippi	1,149,000
Missouri	709,000
Montana	267,000
Nebraska	260,000
Nevada	399,000
New Hampshire	239,000
New Jersey	696,000
New Mexico	642,000
New York	757,000
North Carolina	970,000
North Dakota	61,000
Ohio	1,520,000
Oklahoma	1,562,000
Oregon	438,000
Pennsylvania	1,484,000
Rhode Island	87,000
South Carolina	1,116,000

(continued)

States	Amount
South Dakota	$271,000
Tennessee	1,506,000
Texas	2,180,000[a]
Utah	978,000
Vermont	98,000
Virginia	3,032,000
Washington	809,000
West Virginia	383,000
Wisconsin	252,000
Wyoming	132,000
Subtotal	**$42,271,000**

Other Recipients	
District of Columbia	$734,000
Panama	1,375,000
County and municipal governments	265,000
U.S. Territories	54,000
Subtotal	**$2,428,000**
Total	$44,699,000
Unspecified	$105,000
Grand total	**$44,804,000**[b]

[a]Taxes for 1987 were reduced to about $2.2 million by a special tax credit of about $2.3 million granted one plan.

[b]The grand total of $44.8 million shown above is about $700,000 more than the $44.1 million actually charged to the program in 1987, largely because two of the plans reported their distribution on a cash basis, while the plans reported the amount actually charged to the program on an accrual basis

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