Report on the Importance of the Tax Exemption for Employer Health Benefits in Canada

JOHNSTON GROUP

Brief Background on the Issue of the Elimination of the tax exemption for employer-based health and dental plans

From the Report of the Advisory Panel on Health Care Innovation - July 2015

- In July 2015 the Advisory Panel released a report titled "Unleashing Innovation: Excellent Health Care for Canada"
- The report, which took a year to produce, was focused on the Federal Government's role within the existing Canada Health Act and was commissioned by the previous Federal Government under then Health Minister Rona Ambrose and chaired by David Naylor.
- The following recommendation was made, which is still under consideration by our current Federal Government.

Financial Fairness in a Period of Transition

Through the Department of Finance, and in collaboration with Health Canada, pursue the following initiatives (10.1):

- Examine the current partial GST/HST rebate system for public sector bodies to reduce distortions arising from differential tax treatment of hospitals, municipalities, non-for-profit organizations and charities that deliver health care services.
- Create a new Refundable Health Tax Credit (RHTC) to provide tax relief of 25 percent on eligible out-of-pocket health care expenditures up to $3,000 per year, replacing the Refundable Medical Expense Supplement.
    - The RHTC would apply to the first-dollar spent on eligible expenses, and would be income-tested, with the full value of the credit made available to lower-income Canadians who bear a significant cost relative to their means. It would be administratively simple for tax filers, with tax slips issued by insurers and providers of health services. Payments to individuals with recurring expenses could be made on a quarterly basis.
- Make employer-paid premiums for employer-sponsored health and dental benefits a taxable benefit to the employee, while permitting employees to claim this expense as a qualifying medical expense under the new RHTC or METC.

Review of Federal Tax Credits

The current Federal Government, through the Minister of Finance, launched a sweeping review of 150 tax credits worth about $100 Billion a year in foregone federal revenue. The Department of Finance has launched a review conducted by seven external experts to look at the tax system to ensure it is as **fair, efficient, and simple as possible. It is not supposed to be about revenue.**

They have reviewed the health and dental benefit exemption but it is unknown at this point what, if any, their recommendation includes. The Finance Minister has stated that his government is committed to continuing to make changes to the tax system in areas that no longer have a desired impact. The employer-sponsored health and dental tax exemption currently represents $2.9 Billion in potential revenue for the Federal Government.

THE $2.9 BILLION THAT THE GOVERNMENT CURRENTLY DOES NOT COLLECT BY NOT TAXING EMPLOYER-BASED HEALTH AND DENTAL PLANS HELPS TO INCENT MORE THAN $32.2 BILLION IN HEALTH CARE DELIVERED TO CANADIANS.

Arguments in Support of the Elimination of the Employer-Sponsored Health and Dental Tax Exemption

- The Federal Government's review of federal tax credits is based on a measure of fairness, efficiency, and simplicity. It is the opinion of some that the elimination of this exemption would lead to greater fairness. Their view is that a tax exemption that only applies to those that have an employer benefit plan is supported at the expense of those that do not. The perception is those that have private and individual benefit plans that pay tax on those plans are subsidizing those that receive the exemption. It is further assumed that those on their own plans are typically of a lower income bracket and the exemption favours high income Canadians.

- The push to eliminate the credit is based on the perception that lower income Canadians do not receive employer-based benefits and are left to invest in private and personal plans. One proposal is to institute a re-invented Medical Expense Tax Credit that will allow all Canadians to receive a tax benefit equally as long as they meet a certain income test.

- Others also believe that since other benefits, such as life insurance, are a taxable benefit it provides an inconsistent, complicated, and inequitable approach to the tax treatment of employer benefits.

- The elimination of the exemption would deliver $2.9 Billion to the Federal Treasury, which appeals to many that look at this through a fiscal lens.

- The federal government says that they will not be looking at any tax credit in isolation but will be part of an overall review of all credits.

Arguments Opposing the Elimination of the Employer-Sponsored Health and Dental Tax Exemption

Will Result in Reduced Private Investment in Health Care in Canada and Reduce the Access and Quality of Health Coverage for Canadian Families

- The tax benefit has helped to increase the amount of resources going to health care in Canada and has served to take some of the pressure off escalating health care costs for governments. The potential to get more companies invested and even keeping current companies with benefit plans for their employees is severely diminished through making these benefits taxable. We need only look at what Quebec experienced in 1993 when they reduced the tax benefits on employer-based benefit plans. Almost 20% of all companies and 50% of small employers that had plans removed them and many others reduced their benefit offerings providing lower benefit support for their employees.

- Private plans tend not to be popular with Canadians and the drop off that would surely be experienced after such a move would not likely be followed by an off-setting take-up of private plans. Individual plans tend to be very limited in terms of the quality of coverage and even if more Canadians chose this route, it would provide a collectively lower level of coverage. More individuals would be left exposed to escalating drug costs and disability income shortfalls than they are under the current system.

- Workplaces provide great platforms for increased investment in health care and is an important part of the effort to deliver better health outcomes. With basic health and dental coverage comes the opportunity for ever-increasing focus and investment in wellness. There is an increasing interest in workplace wellness and in particular mental wellness. The tax imposed on employer-based plans would dramatically reduce the potential for increased employer investment in wellness benefits. The increase in the usage of Employee Assistance Programs is a symptom of both the increasing prevalence of mental illness and also the employer-based resources that provide the tools necessary to deal with it. Employers have a role to play to not only increase the investment in health care but also provide an environment and resources available that will improve health and wellness outcomes. The elimination of the tax exemption would effectively serve to move us in the opposite direction. It is important for the Federal Government to look at the long term and be careful not to make a short term tax decision that will have the unintended consequence of reducing effective health investment and health outcomes.

ACCORDING TO A RECENT IPSOS POLL 70% OF CANADIANS ARE OPPOSED TO THIS PLAN – 48% SAID THEY WOULD PREFER TO TAKE CASH OVER HEALTH BENEFITS IF THEY WERE TAXED AT THE SAME RATE – AND 84% WOULD END UP DELAYING OR FOREGOING TREATMENT OR MEDICATION IF THEY DIDN'T HAVE COVERAGE

- Drawing the conclusion that those that receive employer-based benefits are receiving higher incomes is not accurate. There are a number of low income professions that are part of companies covered by a group benefit plan. Many of these low income positions are in smaller companies. These employees rely upon their employer co-investing in these benefits that allows them access to affordable benefits.

- As the Federal Government seeks to find a health care system that is sustainable for Canadians, they should work closely with employers as a significant co-funder to find effective ways to satisfy the increasing demand for health services by Canadians.

Will Create Challenges for Canadian Business and Make Them Less Competitive, Especially Small Business, and Will Increase Costs for the Average Canadian

- The tax exemption on health and dental helps make the benefits more affordable. As health care costs continue to rise dramatically, it becomes increasingly difficult for Canadian companies, especially small companies, to afford coverage for their employees. Employers that access and invest in an employee benefit plan should be commended and encouraged to do so. This change would be a real blow to SMEs in Canada.

- Small companies, which make up 98.2 % of businesses in Canada and create 77.7% of all new private jobs in Canada, are increasingly investing in employee benefits and even expanding their benefit portfolios in order to recruit and keep their employees. The capacity gap between large and small companies is ever-increasing and benefit plans are becoming an important equalizer and very much a competitiveness issue. This change would serve to make small businesses increasingly uncompetitive in attracting and retaining the talent they need.

- Improved access to benefits to micro-businesses has meant that these companies, that represent our potential high growth firms, will have an easier time recruiting the talent they need to facilitate their growth. This target market will likely be the first to drop their benefit program.

- Taxing employer health benefits will trigger the requirement for CPP and EI contributions on those amounts. There would be an incremental cost of CPP and EI for insured employees whose current earnings from employment are below the YMPE and insurable earnings threshold as well as a cost on the employers of those affected employees. We estimate the cost could be over $1 billion. This cost will fall on the lower-middle income Canadians who earn above $15,000 and below $55,000 and their employers. This incremental cost for employers further reduces their ability to afford the benefit plans and /or sustain employment levels.

Will Provide Disincentive for Employers to Invest More in Workplace Wellness and Prevention Programs and Benefits

- The preventative nature of the benefit plans of today provides the best solution to escalating health care costs. Lowering disability and other claims through better prevention is not only where many employer-based plans are going but workplaces provide a very effective platform for prevention and improving health outcomes. Prevention must be our priority and an expansion of employer-based wellness programs will go a long way to getting results and reducing costs overall. Research shows that for every $1 spent on prevention you save $3 in health care costs down the road.

- Private health care provides access to many paramedical services that are critical for helping individuals stay healthy and out of physician offices and hospitals. Less access to these benefits will likely result in higher physician and hospital costs as well as a decrease in the overall health status of Canadians.

- Introducing a refundable tax credit would likely cost more to the treasury than the savings from taxing health benefits (Source: Naylor Report).

75% OF CANADIANS AND A TOTAL OF 24 MILLION CANADIANS HAVE ACCESS TO CARE THROUGH THESE BENEFITS

- The METC is a poor substitute as it 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.

- Even if a refundable tax credit against individual insurance costs at the lower level income bracket is introduced (as speculated in the media and recommended by the Naylor Report), the dynamics of the individual insurance market are such that a huge gap will remain.

  - Healthy, younger individuals often forgo purchasing insurance.

  - Older individuals, who typically have more complex health needs, tend to seek insurance, but will be subject to full insurance underwriting. That means higher costs for comparable coverage and in fact, some may not qualify for insurance based on their health status.

  - The present system provides supplementary health coverage across a very large part of the population at a much more reasonable cost than individual insurance where anti-selection costs will be much higher.

  - Individual health plans often include caps and other limits that many group plans do not.

This Proposed Change Will Put Increasing Pressure on Provincial Governments at a Time When They Are Looking For an Increase in Federal Transfers for Health Care

- Over time, as the quality and amount of insurance coverage declines for individuals, there will be pressure on governments to step in to provide support. This pressure will fall to provincial governments who are not looking for incremental health care exposure.

- In most provinces, the province pays a large part of drug costs for individuals who do not have private drug coverage. As a very large number of Canadians will not obtain individual coverage (because they do not need it or it is too expensive as they are high risk), this additional burden will fall on provincial plans that are already straining under increased drug costs.

Conclusion

The Federal Government would be ill-advised to pursue the elimination of the employer-based tax exemption for health and dental benefits. It will only serve to reduce the overall private investment in health care in Canada placing greater demands on public health budgets at the Federal and Provincial levels. It will place a greater burden on millions of middle and low income Canadians resulting in a lower a level of health coverage. It will increase the difficulty smaller employers will have in competing for human resource talent and it will reduce the potential for increased investment in benefit plans that lead to prevention. The negative consequences of this change far out-weigh any benefit Canadians will receive.

Recommendation

The Federal Government immediately announce that they will not pursue the elimination of the exemption for employer-sponsored health and dental benefits.

The Federal Government will work with the industry to address barriers to employer benefit programs, particularly Canadian small businesses, to develop policies or programs that will result in better health outcomes for Canadian employees and their families.