

**WRITTEN TESTIMONY
OF THE STAFF OF THE JOINT COMMITTEE ON TAXATION
REGARDING IMPLEMENTATION ISSUES INVOLVED IN
VARYING MEDICARE PART B PREMIUMS BY INCOME**

**FOR A HEARING
OF THE
SUBCOMMITTEE ON HEALTH
OF THE
HOUSE COMMITTEE ON WAYS AND MEANS
ON
FEBRUARY 7, 1995**

**PRESENTED
BY
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U.S. CONGRESS**

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I. INTRODUCTION

My name is Ken Kies. I am the Chief of Staff of the Joint Committee on Taxation. It is my pleasure to present the testimony of the Joint Committee at this hearing concerning the Medicare Part B premium.

In particular, the Health Subcommittee is considering whether to reduce the subsidy value of the Supplemental Medical Insurance program under Medicare ("Part B") for certain beneficiaries by adjusting the Medicare Part B premium through the Federal income tax system. My testimony will not discuss whether adopting such a proposal is advisable (the testimony of other witnesses should address this issue), but instead will focus on the enforcement, administrative and structuring issues that could arise in implementing such a proposal. We believe that such implementation issues should be considered when proposals are being developed so that problems may be identified and addressed in a manner that imposes the least possible burden on the Internal Revenue Service ("IRS") and affected taxpayers.

First, this testimony briefly describes the Medicare Part B program under present law. Second, background information is provided on previous proposals to increase Part B premiums for higher-income beneficiaries. Third, a general description of the proposal under consideration is presented. Finally, the testimony discusses major implementation issues.

As always, the Joint Committee staff looks forward to working with the Subcommittee to develop and refine specific proposals relating to the Part B premium.

II. PRESENT LAW

The Medicare program consists of two parts: the hospital insurance (Part A) program and the supplementary medical insurance (Part B) program.

In general, and within certain limits, Medicare Part A pays for inpatient hospital care, skilled nursing facility care, home health care, and hospice care. Medicare Part A is financed by the Hospital Insurance Trust Fund, primarily through the payment of payroll taxes.

Most Americans age 65 or older are automatically entitled to protection under Part A of Medicare with no premium requirement based on work performed in employment subject to Social Security payroll taxes. Persons age 65 or older who are not "fully insured" (i.e., not eligible for monthly Social Security or railroad retirement benefits) may obtain coverage under Part A, providing they pay the full actuarial cost of such coverage. Also eligible, after a two-year waiting period, are people under age 65 who are receiving monthly Social Security benefits on the basis of disability, and disabled railroad retirement system annuitants. Most people who need a kidney transplant or renal dialysis because of chronic kidney disease are, under certain circumstances, entitled to benefits under Part A regardless of age.

In general, and within certain limits, Medicare Part B provides coverage for doctor's services and certain other medical services (such as laboratory services and outpatient hospital services), and home health services for persons not covered under Medicare Part A.

Unlike Medicare Part A, Part B coverage is not automatic, but depends on the payment of a premium. All persons age 65 or older (whether automatically entitled to benefits under Part A or not) may elect to enroll in Part B by paying the monthly premium. Persons eligible for Part A by virtue of disability or chronic kidney disease may also elect to enroll in Part B. Individuals may terminate their enrollment in Part B at any time by filing a notice with the Social Security Administration. The Part B premium is increased by 10 percent for each full year out of the program for persons who do not enroll as soon as they are eligible.

The Part B premium for any year was originally set at the lower of: (1) an amount sufficient to cover one-half of the costs of the program for the aged or (2) the current premium amount increased by the percentage by which cash benefits were increased under the cost-of-living adjustment (COLA) provisions of the Social Security program. Premium income, which originally financed half of the costs of Part B, declined under this formula to less than 25 percent of total program income because of the COLA limitation.

The Tax Equity and Fiscal Responsibility Act of 1982 temporarily suspended the COLA limitation for two years, 1984 and 1985. During this period, enrollee premiums were allowed to increase to amounts necessary to produce premium income equal to 25 percent of program costs for elderly enrollees. The suspension of the COLA provision was further extended in subsequent legislation through 1990. The Omnibus Budget Reconciliation Act of 1990 set the premium rates in law for each of the years 1991-1995, based on estimates of the amount necessary to cover 25 percent of program costs for these years. The monthly premium is \$46.10 in 1995, which is projected to cover 31 percent of program costs. Because these statutory amounts were based on estimates, the premium income in any year subject to the statutory rates could be more or less than 25 percent of actual program costs. In 1996 through 1998, the premium will be adjusted to be 25 percent of program costs.

In most cases, the Part B premium is deducted automatically from Social Security or railroad retirement benefits. Eligible persons not yet receiving Social Security or railroad retirement benefits are billed quarterly.

The approximately 70-75 percent of Medicare Part B costs that are not paid by premiums is financed through general revenues.

III. BACKGROUND AND DESCRIPTION OF PROPOSAL

Over the years, there have been a number of proposals, which have received bipartisan support, to reduce the subsidy value of the Medicare Part B program for certain beneficiaries by adjusting the Part B premium.

For example, such a proposal was an option under consideration as part of the 1990 Budget Summit between the Bush Administration and Congressional leaders. In his fiscal year 1992 budget, President Bush proposed increasing the Part B premium to equal approximately 75 percent of program costs for beneficiaries with adjusted gross incomes greater than \$125,000 for single beneficiaries and \$150,000 for couples. Similar proposals have been made in subsequent budgets.

Last year, President Clinton included a "recapture" of the Part B subsidy for high-income taxpayers as part of the Administration's Health Security Act. Under that proposal, the Part B premium would have increased to approximately 75 percent of the program costs for taxpayers with modified adjusted gross income ("AGI") in excess of \$105,000 in the case of single taxpayers, \$130,000 in the case of a married couple with one spouse covered under Part B, and \$145,000 in the case of a married couple with both spouses covered under Part B.

Other health care reform bills considered in the 103rd Congress contained similar proposals, including those sponsored by Congressman Michel (R-IL) and Senator Lott (R-MS) (H.R. 3080 and S. 1533), Congressman Cooper (D-TN) and Senator Breaux (D-LA) (H.R. 3222 and S. 1579), and Congressman Thomas (R-CA) and Senator Chafee (R-RI) (H.R. 3704 and S. 1770). A similar proposal was not contained in the Health Security Act as adopted by the Committee on Ways and Means, but was included in the Health Security Act as adopted by the Senate Finance Committee.

Under all these proposals, additional Part B premiums would have been collected from the affected taxpayers through the Federal income tax system.

In the 103rd Congress, H.R. 3704 was introduced by Chairman Thomas. As I have previously mentioned, this health reform bill also contained a provision to income relate the Medicare Part B premium. Under this provision, taxpayers with modified AGI in excess of \$100,000 in the case of a single taxpayer and \$125,000 in the case of a married taxpayer filing a joint return would have been required to pay Medicare Part B premiums equal to 75 percent of the average costs of the program for each month of the year that a Medicare Part B premium was paid. The additional premium in excess of the premium collected under present law would have been phased in between \$90,000 and \$100,000 of modified AGI for single taxpayers and \$115,000 and \$125,000 of modified AGI in the case of married taxpayers filing a joint return. Modified AGI for purposes of this provision would have been the same as the definition of modified AGI for social security benefit taxation.

I understand that the Subcommittee is considering ideas similar to those considered in the above referenced bills. Although there is no specific proposal under consideration, the general proposal being considered by the Subcommittee is that taxpayers with incomes above certain levels would be required to pay additional Part B premiums. The total premium increase would be phased in over some income levels that would be specified. In the case of married couples, whether an additional premium is owed would be determined for each spouse based on whether he or she is enrolled in Medicare Part B, using the combined income of the couple. The premium generally would be collected the same way that Federal income taxes are collected. Any additional premiums would be included as an additional amount owed on the individual's tax return for the year.

IV. ISSUES INVOLVED IN IMPOSING AN INCOME-RELATED MEDICARE PART B PREMIUM THROUGH THE FEDERAL TAX SYSTEM

If the Subcommittee determines that it is appropriate to impose a Medicare Part B premium that is income related, there are a number of issues that you may wish to consider if the income-related premium is assessed through the Federal tax system. Key issues for the Subcommittee to decide include the income levels at which the increased premium would be paid and the amount of the additional premium (i.e., whether the total Part B premium owed would be 100 percent of the program costs or a lesser amount). Factors that should be taken into account in determining these amounts include the ability of taxpayers at higher income levels to pay additional premiums, revenue constraints (if any), and the effect of increasing the premium on the decision to enroll in Medicare Part B.

My testimony focuses on issues that arise regardless of the decisions as to particular income levels or premium levels. In adopting a particular proposal, I would encourage you to consider implementing it in a manner that is easiest for both taxpayers and the IRS to administer.

Phasing in an income-related Part B premium

Whenever a tax is imposed on taxpayers with income above a certain level, the issue of whether the tax should be phased in must be considered. If a higher rate of tax is assessed on income above a certain level, a taxpayer's marginal tax rate increases as income rises. If a specified amount of additional tax is imposed for taxpayers with income above certain levels, the marginal rate for the first dollar of income above the threshold could be extraordinarily high, unless the additional tax is phased in over an adequate income range to smooth the effects of the phase in.

For example, suppose the Congress imposed a \$1,000 surtax on taxpayers with income in excess of \$50,000 per year. Ignoring any other taxes that a taxpayer might owe, if this tax were not phased in, a taxpayer with \$50,001 of income would be required to pay additional tax of \$1,000. This would result in a marginal tax rate (assuming no other taxes) on that \$1 of additional income of 100,000 percent. On the other hand, a taxpayer with income of \$100,000 would be subject to a marginal tax rate of 2 percent on his income in excess of \$50,000.

The Congress often phases in tax increases of this nature so that these distortions in marginal tax rates can be minimized. Most of the proposals to impose an income-related Medicare Part B premium would phase in the additional premium for this reason. The issue then presented is the income range over which the additional premium should be assessed.

It may be appropriate to choose an income range over which the additional Part B premium is phased in that does not coincide with the phase-in range for the taxation of Social Security benefits. Because virtually all Medicare-eligible taxpayers are those who are also likely to be receiving Social Security benefits, the effect of imposing a Medicare Part B premium increase over the same income

range as the taxation of Social Security benefits is phased in could result in what the Congress would conclude is an inappropriately high marginal tax rate for the affected taxpayers.

Under present law, taxpayers with income in excess of \$25,000 in the case of a single taxpayer and \$32,000 in the case of married taxpayers filing a joint return must include in income up to 50 percent of their Social Security benefits. In addition, taxpayers with income in excess of \$32,000 in the case of single taxpayers and \$44,000 in the case of married taxpayers filing a joint return must include in income up to 85 percent of certain of their Social Security benefits. The additional amount that must be paid phases in as income above these amounts increases relative to the amount of Social Security benefits received. The Contract with America would repeal the second level of Social Security taxation. In general, under present law, if the increased Part B premium began at incomes in excess of approximately \$36,000 for single individuals and \$52,000 for married taxpayers, the taxation of Social Security benefits would be fully phased in before the Part B premium had an effect. If the Contract With America provision relating to the repeal of the tax increase in social security benefits enacted in the Omnibus Budget Reconciliation Act of 1993 is enacted, then the levels at which the taxation of social security benefits is fully phased in would generally be reduced to \$32,200 for single taxpayers and \$46,400 for married taxpayers filing a joint return.

In addition, it may be appropriate to select the phase-in threshold and range in such a manner that the adoption of a proposal to income relate the Part B premium does not result in the creation of an additional marriage penalty. Under present law, in the case of a married couple in which both spouses have income, it is possible that the couple will pay more Federal income tax by filing a joint return than the amount of tax that would be due if each of the spouses were eligible to file as single individuals. This is the so-called marriage penalty. The Contract With America contains a provision that is designed to reduce the marriage penalty to some extent. If the Subcommittee believes that it is important to minimize the marriage penalty, then it would be necessary to set the phase-in threshold for a married couple for purposes of the additional Part B premium at two times the threshold for single individuals. In addition, because the amount of the additional Part B premium owed by a couple is dependent upon whether one or both of the spouses is covered under Medicare Part B, it may be appropriate to phase in the additional premium over the same range as an individual taxpayer in the case of a married couple with only one spouse covered under Medicare Part B and over two times the phase-in range of an individual taxpayer if both spouses are covered under Medicare Part B.

You may also wish to consider indexing the income levels over which the increased premium is phased in. If the income levels are not indexed, then, over time, the real income level at which the premium is phased in will decline and people with lower real incomes will be subject to the additional premium. This effect will be exacerbated if the Part B premium increases over time.

Definition of income

In order to determine the amount of additional Part B premium that is required to be paid by a taxpayer, it is necessary to determine the definition of income to be applied in determining whether

the taxpayer is over the required threshold for the phase in of the Part B premium increase. The principal goal should be to select a definition of income that accurately reflects the taxpayer's ability to pay and that is commonly calculated by taxpayers so as to reduce the potential complexity of the premium calculation.

There are many possible definitions of income that could be employed. A commonly used definition when the phase-in technique is employed is adjusted gross income (AGI). Often, AGI is the starting point in the definition of income and then additional adjustments are made to reflect more accurately a taxpayer's ability to pay.

One definition of income used by almost all taxpayers who would be subject to the additional Part B premium is the definition used for purposes of the taxation of certain Social Security benefits. This definition begins with AGI, but is adjusted to include tax-exempt interest income and to disregard the exclusion from income for interest on certain educational savings bonds and certain foreign tax credits and exclusions. Use of this definition would have the advantage not only of using a definition already employed by the class of taxpayers affected by the Part B premium increase, but also of ensuring that the marginal tax rate concerns addressed above could be mitigated.

Administrative issues

Whenever the Congress enacts new Federal tax treatment of certain income, issues as to administration and enforcement must be considered. The most significant of these issues in the case of imposing an income-related Part B premium through the Federal income tax system are (1) how and when will the additional premium be paid and (2) the need for new reporting or recordkeeping requirements.

It would be a relatively simple matter to collect the additional Part B premium on a taxpayer's Federal income tax return or Form 1040 for each year. It must be determined whether the additional Part B premium will be subject to the estimated tax provisions or whether it will merely be collected as a separate tax on the Form 1040. If it is collected through the estimated tax system, then the additional premiums will be collected more closely to the time that the Part B coverage is provided. On the other hand, a taxpayer will not know with certainty whether his or her income for the year will be sufficiently high so that the additional Part B premium will, in fact, be owed and, if so, the amount of the additional premium. Thus, it may be a simpler calculation for taxpayers if the additional Part B premium is collected only at the end of the taxable year and is not subject to estimated tax payments during the year. To resolve this issue, the Subcommittee will have to determine whether simplicity of the calculation for taxpayers outweighs the Federal government's interest in collecting the additional Part B premium close to the time that the coverage to which the premium relates is provided.

In some cases, a taxpayer's AGI may be redetermined by the IRS after the tax return is filed. Such a redetermination could affect the amount of additional Part B premium that is owed, and could mean that the taxpayer is entitled to a refund or owes an additional amount. If the Part B premium

is treated the same as Federal income taxes, then the IRS will automatically recalculate the Part B premium if AGI is redetermined and will make appropriate adjustments to the taxpayer's total tax liability.

Another issue that must be considered is whether it is necessary or appropriate to impose reporting requirements so that the IRS is capable of determining, from the face of a taxpayer's Form 1040, whether the taxpayer is subject to the additional Part B premium. For example, the Subcommittee might consider whether it is appropriate to require that a statement be provided to a Medicare-covered individual for each year indicating the months of Medicare Part B coverage for the year. This statement could then be attached to the taxpayer's Form 1040 for the year. However, in virtually all cases, a taxpayer who is subject to the additional Part B premium would also be claiming the additional personal exemption for the elderly. In such a case, the IRS would generally know that a taxpayer with sufficiently high income who is also claiming an additional personal exemption for the elderly is likely to be required to pay the additional Part B premium. In some cases, a taxpayer who claims an additional exemption for the elderly will have been covered by Medicare Part B for only part of a year, but it should be a relatively minor problem to resolve discrepancies in such cases.

Some taxpayers who are under age 65 are also Medicare eligible (e.g., certain disabled individuals or individuals with end-stage renal disease) and may have sufficiently high income that they would be required to pay the additional Part B premium. The Subcommittee should consider whether it is appropriate to adopt a specific reporting requirement to ensure that high-income taxpayers who are under age 65 and covered under Medicare are paying the additional Part B premium. However, this may be such a small class of taxpayers that it may not be worth the administrative costs of imposing such a reporting requirement.

Fairness

Some people who would be subject to an additional income-related Part B premium may elect to decline Part B coverage as a result of the additional premium. Others who are currently covered under Medicare Part B may feel that enactment of an income-related Part B premium unfairly increases the cost of the program to them. They may argue that they would not have elected Part B coverage in the first place if they had known that they would be subject to a significant premium increase. Under present law, persons in Part B may terminate Part B coverage by notifying the Social Security Administration. Thus, persons who wish to terminate coverage due to the increased premium can do so. However, to avoid an appearance of unfairness, the Subcommittee may want to consider whether it is appropriate to provide special notice of the right to terminate coverage when the Part B premium is effective, and the consequences if the person would later like to again be covered (i.e., the premium increase). The costs of providing such a notice should be weighed against the benefits to Part B recipients.

V. CONCLUSION

In closing, I would like to give the Subcommittee an idea of the magnitude of the revenue involved if an income-related Medicare Part B premium were imposed. Assume an individual covered under Medicare Part B were required to pay an additional premium so that the total amount paid by the individual equaled 75 percent of the average costs of the program. In addition, assume that this additional premium would be phased in over a \$10,000 range beginning at AGI of \$50,000 in the case of a single taxpayer and \$100,000 in the case of a married taxpayer filing a joint return. If this type of proposal were effective beginning in 1996, it is estimated that additional revenues of \$8.1 billion would be collected over the fiscal year 1996-2000 period. Obviously, larger or smaller amounts of revenue could be raised depending upon where the income thresholds are set, the range over which the additional premium is phased in, and the magnitude of the Part B premium imposed.