

HEALTH INSURANCE PREMIUM CONVERSION OPTION FOR FEDERAL CIVILIAN AND MILITARY RETIREES

JULY 7, 2004.—Ordered to be printed

Mr. TOM DAVIS of Virginia, from the Committee on Government Reform, submitted the following

R E P O R T

[To accompany H.R. 1231]

The Committee on Government Reform, to whom was referred the bill (H.R. 1231) to amend the Internal Revenue Code of 1986 to allow Federal civilian and military retirees to pay health insurance premiums on a pretax basis and to allow a deduction for TRICARE supplemental premiums, having considered the same, report favorably thereon with an amendment and recommend that the bill as amended do pass.

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The technical amendment (stated in terms of the page and line numbers of the introduced bill) is as follows:

Page 5, line 10, strike “period” and insert “period.”.

COMMITTEE STATEMENT AND VIEWS

PURPOSE AND SUMMARY

H.R. 1231 would allow federal civilian and military annuitants to pay their Federal Employee Health Benefit Plan (FEHBP) premiums on a pretax basis, and allow active duty military personnel to apply a below-the-line deduction for TRICARE supplemental premiums and enrollment fees.

BACKGROUND AND NEED FOR LEGISLATION

Under Section 125 of the Internal Revenue Code, employers in the public and private sectors currently have the authority to permit their employees to pay for health insurance with wages excluded from both income and social security payroll taxes. This benefit was extended to federal employees in October 2000 and is available to many employees in the private sector.

Under current law, amounts distributed from a section 401(a) qualified retirement plan and used to pay for benefits in a former employer's section 125 cafeteria plan must be included in the participant-retiree's income, and are therefore taxable to the individual in the taxable year in which distributed. As a result, public and private sector employers are unable to make these benefits available to annuitants.

According to GAO, FEHBP premiums have increased by an average of nearly 10 percent a year since 1998, a trend which promises to continue into the near future given the increased costs for prescription drugs and outpatient care. Conversely, COLAs have only increased by 2.38 percent for CSRS and 1.96 percent for FERS over the last 5 years. It is critical for annuitants to receive relief since they have been forced in recent years to shoulder increasingly high health insurance and prescription drug costs on their average monthly annuity of \$1,869 and average annual annuity of \$22,428.

LEGISLATIVE HISTORY

H.R. 1231 was introduced by Representative Tom Davis on March 12, 2003, and referred to the Committee on Ways and Means, the Committee on Government Reform, and the Committee on Armed Services. Following mark-up by the Subcommittee on Civil Service and Agency Organization on July 16, 2003, H.R. 1231 was reported by the committee on September 25, 2003.

SECTION-BY-SECTION

Section 1: Pretax payment of health insurance premiums by federal civilian and military retirees

Section 1 amends Section 125 of the Internal Revenue Code to allow federal civilian annuitants to pay premiums for their health insurance, established under Chapter 89 of Title 5, prior to the reduction for income and social security payroll taxes.

Additionally, Section 1 amends Section 125 of the Internal Revenue Code to allow a member or former member of the uniformed services to pay premiums for their health insurance, established under Chapter 55 of Title 10, prior to the reduction for income and social security payroll taxes.

Section 2: Deduction for TRICARE Supplemental premiums

Section 2 amends the Internal Revenue Code to provide an annual deduction in taxable income for the expense of purchasing TRICARE Supplemental coverage, available for taxable years beginning after the date of the enactment.

Section 3: Implementation

Section 3 directs the Director of the Office of Personnel Management and the Secretary of Defense to take the administrative actions necessary to ensure the benefits authorized by this legislation are made available to their annuitants during the first open enrollment period that occurs 90 days following enactment.

EXPLANATION OF AMENDMENTS

No amendments were adopted by the committee.

COMMITTEE CONSIDERATION

On September 25, 2003, the Committee met in open session and ordered reported favorably the bill, H.R. 1231 by voice vote, a quorum being present.

ROLLCALL VOTES

No rollcall votes were held.

APPLICATION OF LAW TO THE LEGISLATIVE BRANCH

Section 102(b)(3) of Public Law 104–1 requires a description of the application of this bill to the legislative branch where the bill relates to the terms and conditions of employment or access to public services and accommodations. This bill would allow federal civilian and military annuitants to pay their FEHBP premiums on a pretax basis, and allow active duty military personnel to apply a below-the-line deduction for TRICARE supplemental premiums and enrollment fees. Retired legislative branch employees and their families, to the extent that they are otherwise eligible for the benefits provided by this legislation, have equal access to its benefits.

STATEMENT OF OVERSIGHT FINDINGS AND RECOMMENDATIONS OF THE COMMITTEE

In compliance with clause 3(c)(1) of rule XIII and clause 2(b)(1) of rule X of the Rules of the House of Representatives, the Committee's oversight findings and recommendations are reflected in the descriptive portions of this report.

STATEMENT OF GENERAL PERFORMANCE GOALS AND OBJECTIVES

In accordance with clause 3(c)(4) of rule XIII of the Rules of the House of Representatives, the Committee's performance goals and objectives are reflected in the descriptive portions of this report.

CONSTITUTIONAL AUTHORITY STATEMENT

Under clause 3(d)(1) of rule XIII of the Rules of the House of Representatives, the Committee must include a statement citing the specific powers granted to Congress to enact the law proposed

by H.R. 1231. Article I, Section 8, Clause 18, the Necessary and Proper Clause, of the Constitution of the United States grants the Congress the power to enact this law.

FEDERAL ADVISORY COMMITTEE ACT

The Committee finds that the legislation does not establish or authorize the establishment of an advisory committee within the definition of 5 U.S.C. App., Section 5(b).

UNFUNDED MANDATE STATEMENT

Section 423 of the Congressional Budget and Impoundment Control Act (as amended by Section 101(a)(2) of the Unfunded Mandates Reform Act, P.L. 104-4) requires a statement whether the provisions of the report include unfunded mandates. H.R. 1231 contains no intergovernmental or private-sector mandates as defined in the Unfunded Mandates Reform Act and would impose no costs on state, local, or tribal governments.

COMMITTEE ESTIMATE

Clause 3(d)(2) of rule XIII of the Rules of the House of Representatives requires an estimate and a comparison by the Committee of the costs that would be incurred in carrying out H.R. 1231. The Committee has received the following cost estimate for H.R. 1231 from the Joint Committee on Taxation:

CONGRESS OF THE UNITED STATES,
JOINT COMMITTEE ON TAXATION,
Washington, DC, June 25, 2004.

Hon. TOM DAVIS,
House of Representatives, Committee on Government Reform, Rayburn House Office Building, Washington, DC.

DEAR CHAIRMAN DAVIS: This is in response to your letter of April 5, 2004, requesting a revenue estimate for H.R. 1231, a bill to modify the tax treatment of certain health insurance premiums paid by active-duty and retired military personnel and Federal civilian retirees.

Present law provides an income tax and Federal Insurance Contributions Act ("FICA") tax exclusion for employer contributions toward health insurance and health care for active employees. Present law also provides that, through the use of a cafeteria plan, active employees may receive an income and FICA tax exclusion for the health insurance premiums that they pay through a salary reduction arrangement. Present law also provides an income tax exclusion for employer contributions toward health insurance and health care for former (or retired) employees, but former employees are not eligible to participate in cafeteria plans. Thus, under present law, former employees cannot receive an income tax exclusion for the health insurance premiums that they pay through a pension reduction arrangement.

Federal civilian retirees who are enrolled in the Federal Employees Health Benefits Program ("FEHBP") pay about one-fourth of the total premium for their FEHBP coverage and the remainder of the premium is paid by the Federal Government.

Active-duty military personnel are automatically enrolled in Tricare Prime and generally have no uncompensated health care expenses. In general, the family members of active-duty military personnel are automatically eligible for benefits under Tricare Standard, Tricare Extra, and Tricare Prime, and pay no health insurance premiums for this coverage. A very small percentage of active-duty military personnel purchase supplemental health insurance for their family members from private health insurance companies.

Retired military personnel and their family members who are under age 65 are automatically enrolled in Tricare Standard and Tricare Extra and pay no health insurance premiums for this coverage. Retirees and their family members may choose to enroll in Tricare Prime. The premiums for retiree coverage under Tricare Prime are currently \$230 per year for single coverage and \$460 per year for family coverage. As an alternative to Tricare Prime, many military retirees enroll in Tricare Standard and Tricare Extra and purchase supplemental health insurance for themselves and their family members from private health insurance companies.

The Department of Defense (“DoD”) sponsors a dental insurance plan for the families of active-duty personnel and a separate dental plan for retirees and their families. DoD pays a portion of the premium for Tricare Dental insurance for active-duty families. Retirees and their families who enroll in the retiree Tricare Dental program pay the full insurance premium.

Section 1 of H.R. 1231 would provide an income tax exclusion for the portion of the pension income of Federal civilian retirees that is withheld to pay the retiree share of premiums for FEHBP health insurance coverage. Section 1 of the bill would also provide an income tax exclusion for the portion of the pension income of military retirees that is withheld to pay retiree premiums for Tricare Prime health insurance and Tricare Dental insurance.

Section 2 of the bill would provide an above-the-line deduction for health insurance that is “purchased as supplemental coverage to the health benefits programs established by chapter 55 of title 10” of the U.S. Code. We assume that this deduction would apply to the premiums paid by active-duty and retired military personnel for private health insurance that is supplemental to Tricare. However, the above-the-line deduction would not apply to the Tricare Dental premiums paid by active-duty military personnel. The Tricare Dental programs are established by chapter 55 of the U.S. Code, and thus are not “supplemental coverage to the health benefits programs established by chapter 55.” We also assume that the above-the-line deduction would not apply to premiums for long-term care insurance, under the assumption that long-term care insurance is not “supplemental” coverage to the health benefits programs established by chapter 55.”

It is our understanding that active-duty military personnel are now paying income and FICA tax on the portion of basic pay that is withheld to pay premiums for Tricare Dental insurance. Chapter 125 of the Internal Revenue Code provides that such premiums may be paid under a cafeteria plan arrangement. Premiums paid in this way are excludable from gross income and FICA taxes. However, the Department of Defense has not implemented a cafeteria plan arrangement for these premiums. H.R. 1231 would not

require that the Department of Defense implement a cafeteria plan arrangement for such premiums. Thus, there is no revenue effect for the bill associated with the payment of Tricare Dental premiums through a cafeteria plan.

H.R. 1231 would be effective for taxable years beginning after the date of enactment. For the purpose of preparing a revenue estimate for the bill, we have assumed that the bill will be enacted on October 1, 2004. Estimated changes in Federal fiscal year budget receipts are as follows:

[Fiscal years, in millions of dollars]							
Item	2005	2006	2007	2008	2009	2005–09	2005–14
Income tax exclusion for FEHBP premiums paid by Federal civilian retirees through pension reduction	–499	–756	–829	–902	–976	–3,962	–10,881
Income tax exclusion for Tricare Prime premiums paid by military retirees through pension reduction	–22	–32	–33	–35	–35	–157	–355
Income tax exclusion for Tricare Dental premiums paid by military retirees through pension reduction	–25	–38	–42	–46	–49	–199	–546
Income tax deduction for Tricare supplemental insurance premiums paid by active-duty military personnel	(¹)	(¹)	(¹)	(¹)	(¹)	–1	–2
Income tax deduction for Tricare supplemental insurance premiums paid by military retirees	–3	–23	–25	–27	–29	–107	–297
Total Revenue Effect	–549	–849	–929	–1,009	–1,089	–4,426	–12,082

¹ Loss of less than \$500,000.

Note:—Details may not add to totals due to rounding.

I hope this information is helpful to you. If we can be of further assistance in this matter, please let me know.

Sincerely,

GEORGE K. YIN.

CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In compliance with clause 3(e) of rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italic, existing law in which no change is proposed is shown in roman):

INTERNAL REVENUE CODE OF 1986

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Subtitle A—Income Taxes

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CHAPTER 1—NORMAL TAXES AND SURTAXES

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Subchapter B—Computation of Taxable Income

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**PART I—DEFINITION OF GROSS INCOME, ADJUSTED
GROSS INCOME, TAXABLE INCOME, ETC.**

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SEC. 62. ADJUSTED GROSS INCOME DEFINED.

(a) GENERAL RULE.—For purposes of this subtitle, the term “adjusted gross income” means, in the case of an individual, gross income minus the following deductions:

(1) * * *

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(19) *TRICARE SUPPLEMENTAL PREMIUMS OR ENROLLMENT FEES.*—*The deduction allowed by section 223.*

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**PART III—ITEMS SPECIFICALLY EXCLUDED FROM
GROSS INCOME**

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SEC. 125. CAFETERIA PLANS.

(a) * * *

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(g) SPECIAL RULES.—

(1) * * *

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(5) *HEALTH INSURANCE PREMIUMS OF FEDERAL CIVILIAN AND MILITARY RETIREES.*—

(A) *FEHBP PREMIUMS.*—*Nothing in this section shall prevent the benefits of this section from being allowed to an annuitant, as defined in paragraph (3) of section 8901, title 5, United States Code, with respect to a choice between the annuity or compensation referred to in such paragraph and benefits under the health benefits program established by chapter 89 of such title 5.*

(B) *TRICARE PREMIUMS.*—*Nothing in this section shall prevent the benefits of this section from being allowed to an individual receiving retired or retainer pay by reason of being a member or former member of the uniformed services of the United States with respect to a choice between such pay and benefits under the health benefits programs established by chapter 55 of title 10, United States Code.*

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**PART VII—ADDITIONAL ITEMIZED DEDUCTIONS FOR
INDIVIDUALS**

Sec. 211. Allowance of deductions.

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[Sec. 223. Cross reference.]

Sec. 223. *TRICARE supplemental premiums or enrollment fees.*

Sec. 224. Cross reference.

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SEC. 223. TRICARE SUPPLEMENTAL PREMIUMS OR ENROLLMENT FEES.

(a) *ALLOWANCE OF DEDUCTION.*—In the case of an individual, there shall be allowed as a deduction the amounts paid during the taxable year by the taxpayer for insurance purchased as supplemental coverage to the health benefits programs established by chapter 55 of title 10, United States Code, for the taxpayer and the taxpayer's spouse and dependents.

(b) *COORDINATION WITH MEDICAL DEDUCTION.*—Any amount allowed as a deduction under subsection (a) shall not be taken into account in computing the amount allowable to the taxpayer as a deduction under section 213(a).

SEC. [223.] 224. CROSS REFERENCE.

For deductions in respect of a decedent, see section 691.

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