STATES OF JERSEY

DRAFT BUDGET STATEMENT 2015 (P.129/2014): AMENDMENT (P.129/2014 Amd.) – COMMENTS

Presented to the States on 16th September 2014
by the Minister for Treasury and Resources

STATES GREFFE

COMMENTS

Deputy J.H. Young of St.Brelade's proposed amendment seeks to introduce income tax relief for the payment of private health insurance premiums by taxpayers over the age of 55.

The Minister for Treasury and Resources strongly opposes this amendment for the following reasons –

- The cost of the relief is very significant and based on the UK's experience could rise significantly whilst incentivising very few new insurance contracts to be taken out.
- A similar form of tax relief was available in the UK from 1990 to 1997, Dame Kate Barker has recently described the relief as "extremely poor value for money".
- A proportion of population people choose to take out private medical insurance without the benefit of tax relief, giving tax relief to these people reduces States revenue without any change on the demand for public health services, this is a "deadweight cost".
- Savings in the public health service only occur where the tax relief incentivises new contracts of private medical insurance, the experience from the UK is that the availability of a more generous form of tax relief than the relief being proposed by the Deputy incentivised very few new contracts.
- These 2 factors have led the Institute of Fiscal Studies/the King's Fund to conclude that these forms of tax reliefs are unlikely to be self-funding, directly contradicting the Deputy's assertion that he expects the measure to be initially cost neutral and resulting in net savings over time.
- In terms of the structure of the relief the Deputy has offered no rationale for why the age threshold should be set at 55, the choice appears arbitrary at best.
- This sort of relief will necessarily add complication to the income tax system in contradictory of the key tax policy principle of having a tax system which is low, broad and simple.
- Tax relief for private medical insurance predominantly benefits higher income households whilst providing no benefit to the lowest income households even if they choose to take out private medical insurance.
- There is a discrepancy between the tax treatment applying employer provided group insurance cover and individuals paying their own premiums, however this does not mean that tax relief should automatically be introduced for individuals without consideration of the cost and effectiveness of that relief.

Cost

The estimated cost of £1.76 million is very significant. The Deputy has indicated that in his opinion the proposal "should at least be cost-neutral in the short term, and should result in net savings for the taxpayer in the medium to long term". The evidence from the UK (see below) has led the Institute for Fiscal Studies ("the IFS") and the King's Fund to state –

> "We have considered whether the introduction of such a rebate could actually be self-financing, in other words, whether the saving to the NHS could be greater than the level of subsidies paid by the Treasury. Our analysis shows that this is unlikely to be the case…"

Consistent with the experience in the UK, the cost of the relief may also rise significantly, whilst very few new contracts of private medical insurance are incentivised.

UK experience – evidence of effectiveness tax relief

The Deputy rightly identifies that the UK introduced a similar form of tax relief for those aged over-60 in 1990 (the relief was subsequently withdrawn in 1997) but fails to outline the evidence of the effectiveness of this type of tax relief arising from that experience. The experience of the UK and the relevant conclusions drawn is helpful summarised in a House of Commons Library Standard Note[1]

The relief was introduced with effect from April 1990. As the Note explains –

> "…initially relief was given at the payer's marginal rate of tax. Higher rate tax payers received relief at 40%, whereas basic rate taxpayers, and those not paying tax, received relief at 25% (then the basic rate of tax). In the November 1993 Budget it was announced that relief would be limited to the basic rate of tax with effect from 6 April 1994 – so that, in effect, the value of this relief would be the same for both higher rate and basic rate taxpayers.
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> Over the first years of its life the cost of the scheme has risen quite consistently, although the numbers of insurance contracts, and individuals covered by those contracts, had not risen accordingly. Estimates given in November 1995 put the cost of tax relief doubling from 1990/91 to 1993/94 from £40 million to £80 million, while the number of contracts qualifying for relief had risen from 350,000 to 375,000; the numbers of individuals covered over this period had rising from 500,000 to 550,000. Although tax relief was now limited to the basic rate, the Exchequer costs continued to rise: over the next 2 years, the cost of relief went from £80 million to £100 million – although only 25,000 more contracts had been covered, extending to an extra 50,000 individuals."

The relief was subsequently withdrawn in 1997. When the relevant legislation was scrutinised in the House of Commons the Financial Secretary said (emphasis added) –

[1] See: http://www.parliament.uk/business/publications/research/briefing-papers/SN01441/tax-relief-for-private-medical-insurance

> "When private medical insurance relief for the over-60s was introduced by the Conservative Government in 1990, they claimed that it would encourage the growth of insurance cover for that group in society. They did not undertake any research to find out whether it would work, and it did not … When the relief was introduced, some 350,000 contracts existed, covering 500,000 individuals. Those people had already purchased medical insurance, so the tax relief was a subsidy to them. No doubt they were very grateful to receive it, but it played no part in their decision to take out insurance ... ***Since 1990 and up to 1997, the number of contracts has increased only marginally, by 10 per cent.--yet the cost to the taxpayer for that 10 per cent. increase is £140 million …***"

In May 2001 the IFS, in conjunction with the King's Fund, published a study[2] which estimated that the saving to the UK Treasury from removing the tax relief more than outweighed any additional costs to the NHS from treating those who had decided not to take out private medical insurance as a consequence of the withdrawal of the relief. The study concluded (emphasis added) –

> "…Another way of increasing total spending on health would be to encourage people to take out PMI[3]. This would have the added effect of reducing the demands on the NHS. Some individuals with PMI would in effect 'opt out' of the NHS for the treatments they were covered for.
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> One possibility would be for the Government to encourage individuals to take out PMI by offering a subsidy. ***We have considered whether the introduction of such a rebate could actually be self-financing, in other words, whether the saving to the NHS could be greater than the level of subsidies paid by the Treasury. Our analysis shows that this is unlikely to be the case, largely because a subsidy would benefit current holders of PMI while the saving to the NHS would only stem from the additional policies that would be sold due to the subsidy.*** It is also the case that the purchase of PMI will lead to a decrease in demands on the NHS by less than the policy cost, as private health care is more costly due to the higher quality of care provided, for example through less waiting and greater provision of private rooms, and the higher costs faced by the private sector.
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> Prior to 1997, such a subsidy existed for the over-60s – individuals with PMI received a subsidy equal to the basic rate of income tax on the cost of their insurance. We analyse the effect of the abolition of this subsidy on the demand for PMI and find that, on our best estimate, there was a 0.7 percentage point decrease in the number of people covered by such insurance[4]. This is equivalent to nearly 4,000 individuals. While this would clearly have led to increased demands on the NHS, the cost of treating these individuals is likely to have been substantially lower than the £135 million annual cost of the subsidy."

[2] See: http://www.ifs.org.uk/docs/private_med.pdf
[3] "PMI" – Private Medical Insurance
[4] It is important to note in that due to the way in which tax relief was given in the UK, the amount of the premium payable by individuals would have actually increased on the withdrawal of the tax relief. Yet still the IFS estimates a very low impact on the number of people with private medical insurance. In Jersey tax relief would not be given at source and hence would have no impact on the premiums actually paid to the insurance company.

The experience of the UK was succinctly summarised by Dame Kate Barker in the interim report from the independent Commission on the Future of Health and Social Care in England[5] (emphasis added) –

> "Tax relief for private medical insurance was introduced for those aged over 60 at the level of basic-rate relief in 1989. ***It proved extremely poor value for money.***"

As the Deputy highlights the issue of tax relief for private medical insurance premiums was raised again in the UK in 2011. Based on the earlier experience the unsurprising position of the UK Government was outlined by the Financial Secretary to the Treasury who stated (emphasis added) –

> "The Government introduce new tax reliefs only when there is a compelling case that to do so would represent a good use of public money. Turning first to cost, we estimate that this relief would have a direct and immediate cost to the Exchequer of at least £135 million pounds a year—a significant amount, especially given the fiscal climate in which we are now operating. That would reflect the cost of restricting relief to the basic rate of tax … ***The vast majority of the cost of providing the proposed tax relief would go to those who already have private medical insurance, and there is therefore no obvious need for a new incentive***.
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> The case for introducing tax relief rests on the proposition that it would encourage significant new take-up of private medical insurance and ultimately be self-financing. However, at this stage we do not have any strong evidence to show how much additional take-up of private medical insurance a tax relief would generate, or how much pressure on NHS resources would be relieved as a result … When a similar relief existed in the 1990s, it had little apparent effect, and the IFS report from 2001 concluded that it was unlikely that such a subsidy for private medical insurance would ever be self-financing."

Therefore the evidence from the UK strongly indicates that this sort of relief does not achieve the Deputy's aims, instead it –

- Gives a tax benefit to those who have already chosen to take private medical insurance without the incentive of tax relief, reducing States revenues whilst having no impact on the demand for public health services.
- Appears to have very little impact on the demand for private medical insurance, the introduction of a more generous form of tax relief in the UK than that being proposed by the Deputy only marginally increased the number of contracts and the subsequent withdrawal of the relief had an even smaller impact.
- Is likely to have a significant adverse impact on the net revenue position of the States

[5] See: http://www.kingsfund.org.uk/sites/files/kf/field/field_publication_file/commission-interim-new-settlement-health-social-care-apr2014.pdf

Age threshold of 55

The Deputy has provided no rationale for why the age threshold has been set at the age of 55. This age does not tie in with any other measures (either income tax or social security) which are determined by reference to age. The choice seems arbitrary at best.

The Deputy needs to explain why he chose 55, rather than 50, 60, 65, etc. Does he have evidence that indicates that premiums increase markedly at age 55?

Inconsistency with key tax principles and "20 means 20"

Introducing this form of relief necessarily add complication to the income tax system and the administration of that system, in contradiction of the key tax policy principle to maintain a low, broad and simple tax system. It will also reverse the decision to remove relief for private medical insurance that was taken as part of the implementation of "20 means 20".

In addition it will disproportionately benefit those who have higher income because –

(i) low income individuals/households are likely to below the income tax exemption threshold and hence will receive no benefit what-so-ever from the tax relief being proposed by the Deputy even if they decide to take out private medical insurance; and

(ii) private medical insurance tends to be taken out by higher income households.

Tax treatment of group private medical insurance cover provided by employers

The Deputy correctly identifies that there is an exemption from a benefit in kind ("BIK") charge where an employer provides group private medical insurance cover for its employees. For the avoidance of doubt however, if an employee takes out private medical insurance personally and the cost of the premiums is met by their employer, or the employer provides an employee with cash amount which is allocated for private medical insurance, both of these amounts are fully taxable on the employee.

Although there is a discrepancy with the tax treatment applying to individuals paying their own premiums, this does not mean that tax relief should automatically be introduced for individuals without consideration of the cost and effectiveness of that relief. As noted above, the available evidence indicates that this relief is very poor value for money.