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Report to Congressional Committees

September 2017

AFFORDABLE CARE ACT

IRS Should Mitigate Limitations of Data to Be Used for the Age and Gender Adjustment for the Tax on High-cost Health Plans

GAO-17-661

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GAO Highlights

Highlights of GAO-17-661, a report to congressional committees

Why GAO Did This Study

Some stakeholder groups have questioned the use of the BCBS FEHBP Standard plan premium costs as the basis of the age and gender adjustment, as stipulated by PPACA. The Consolidated Appropriations Act, 2016 includes a provision for GAO to report on the suitability of using these data for this purpose.

This report examines: 1) the benefits and limitations of using FEHBP BCBS Standard plan data as the basis of the age and gender adjustment, and what alternatives to these data could be considered; and 2) how any limitations to BCBS Standard plan data could be mitigated. GAO reviewed IRS documentation; interviewed industry experts and officials from IRS, the Office of Personnel Management (OPM), the Department of Treasury, and other agencies; reviewed comment letters submitted in response to IRS notices; and analyzed 2010 and 2015 cost and enrollment data from OPM.

What GAO Recommends

GAO recommends that, in implementing the age and gender adjustment, IRS consider taking steps to mitigate the limitations of the BCBS Standard premium cost data, such as by combining data from multiple FEHBP plans. IRS neither agreed nor disagreed with GAO's recommendation, but stated that it would consider the recommendation as it works to implement the age and gender adjustment.

View GAO-17-661. For more information, contact John E. Dicken at (202) 512-7114 or dickenj@gao.gov.

What GAO Found

The Patient Protection and Affordable Care Act (PPACA) included a revenue provision for a 40 percent excise tax on high-cost employer-sponsored health coverage to be administered by the Internal Revenue Service (IRS). The tax would be imposed when an employee's annual cost of coverage exceeds an established dollar limit. This limit could be adjusted upward if an employer's workforce—based on its age and gender characteristics—was likely to have higher health costs than the national workforce, on average. This adjustment, known as the age and gender adjustment, is based on the premise that older individuals and younger females tend to have higher health care costs than other individuals. It is designed to lower the tax burden so that taxes are owed based on the plan design and not based on the health care costs of its members. PPACA stated that this adjustment would be made based on the premium costs of the Blue Cross and Blue Shield (BCBS) Standard plan under the Federal Employees Health Benefits Program (FEHBP).

The BCBS Standard plan has benefits and limitations for use as the basis of the adjustment. The benefits include that it is a large, national, decades-old, convenient data source, in that it is already known by, and available to, the federal government. However, there are some specific limitations to its use.

- The BCBS Standard plan has selection bias within FEHBP because members have a choice among many plans, and, compared to other options available to federal employees, it is a relatively expensive plan that covers members with higher health care costs. GAO's analysis of OPM data found that these higher costs are particularly true for younger members.
- The plan's enrollment has declined in recent years. Furthermore, officials noted that any one plan offering could be discontinued.

The selection bias in the BCBS Standard plan may result in an age and gender adjustment that is not adequate. For example, because the BCBS Standard plan covers young members with higher health care costs, the ratio between the average claims costs of the younger and older members in that plan is smaller than it would be in a plan that did not have that particular selection bias issue. Therefore, the age and gender adjustment could be too small. While experts GAO spoke with identified several potential alternative sources of cost data for use as the basis of the adjustment, those alternatives also had limitations, such as not being convenient sources of data and potentially not being representative of the national workforce.

To mitigate limitations of the BCBS Standard plan, these data could be supplemented with data from other FEHBP plans, such as the BCBS Basic plan, which is known to have younger members with lower health care costs and increasing enrollment. GAO found that using combined data from these two sources could result in a different adjustment for some employers—in particular, for those with older employees. Standards for internal control suggest that effective information is vital for an entity to achieve its objectives. Relying on BCBS Standard plan data alone does not provide IRS with the comprehensive information it may need to determine an adequate age and gender adjustment.

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Abbreviations

BCBS	Blue Cross and Blue Shield
BCBSA	Blue Cross and Blue Shield Association
CBO	Congressional Budget Office
CPI-U	Consumer Price Index for All Urban Consumers
CPS	Current Population Survey
FEHBP	Federal Employees Health Benefits Program
HCCI	Health Care Cost Institute
HHS	Department of Health and Human Services
IRS	Internal Revenue Service
OPM	Office of Personnel Management
PPACA	Patient Protection and Affordable Care Act

U.S. GOVERNMENT ACCOUNTABILITY OFFICE
441 G St. N.W.
Washington, DC 20548

September 6, 2017

The Honorable Orrin Hatch
Chairman
The Honorable Ron Wyden
Ranking Member
Committee on Finance
United States Senate

The Honorable Kevin Brady
Chairman
The Honorable Richard Neal
Ranking Member
Committee on Ways and Means
House of Representatives

The Patient Protection and Affordable Care Act (PPACA), enacted in 2010, included a provision for a 40 percent excise tax on high-cost employer-sponsored health coverage (hereafter referred to as the tax) intended, in part, to raise funds to offset costs associated with the law.[1] The tax would be imposed when the annual cost of coverage for an employee exceeds an established applicable dollar limit, set originally at $10,200 for self-only coverage and $27,500 for coverage other than self-

[1]Pub. L. No. 111-148, §§ 9001, 10901, 124 Stat.119, 847, 1015 (2010), as amended by the Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, § 1401, 124 Stat. 1029, 1059 (2010) (codified as amended at 26 U.S.C. § 4980I). The tax may also limit incentives for providing generous health coverage and, in turn, help limit any overuse of health services. The tax, which would be administered by the Internal Revenue Service (IRS), was originally mandated to be implemented in 2018, but the Consolidated Appropriations Act, 2016 delayed its implementation until 2020. Pub. L. No. 114-113, div. P, tit. I, § 101, 129 Stat. 2242, 3037 (2015).

Health coverage is considered a part of an employee's compensation package, as are employee wages. However, while wages are taxable, health coverage receives an exclusion from taxes so that employers can offer it tax free. The Congressional Budget Office's (CBO) March 2015 baseline estimate was that the tax would cumulatively raise $87 billion in federal revenues by 2025. This included revenue from the excise tax as well as revenue from an expected increase in taxable salaries and wages, the latter resulting from some employers reducing compensation in the form of health insurance and increasing compensation in the form of salaries and wages. See CBO, *Updated Budget Projections: 2015 to 2025* (Washington, D.C.: Mar. 9, 2015).

only.[2] However, this limit could be adjusted upward if an employer's workforce—based on its age and gender characteristics—was likely to have higher health costs than the national workforce, on average. This is known as the age and gender adjustment.

Based on the premise that older individuals tend to have higher health care costs than younger individuals and that younger females tend to have higher health care costs than younger males due to the potential for maternity costs, the age and gender adjustment is designed to lower the tax burden, compared to what it would have been without the adjustment, for employers that have costlier employees so that taxes are owed based on the plan design and not based on member costs. PPACA stipulates that the age and gender adjustment would be made based on the premium cost of the Blue Cross and Blue Shield (BCBS) Standard plan under the Federal Employees Health Benefits Program (FEHBP).[3] Some industry experts have raised questions about the use of the BCBS Standard plan premium cost data as the basis of this calculation, including BCBS Association (BCBSA) representatives who contend that the age and gender makeup, as well as the costs of the BCBS Standard plan members, differ from those of the national workforce.

The Consolidated Appropriations Act, 2016 includes a provision for us to study the suitability of using the BCBS Standard plan premium cost data

[2]For example, under the Federal Employees Health Benefits Program (FEHBP)—the program that provides health care coverage to an estimated 8.3 million federal employees, retirees, and their dependents (as of 2015) through health insurance carriers that contract with the Office of Personnel Management—there are three types of coverage. Self-only coverage is available for the coverage of an individual contract holder. When an individual contract holder has eligible family members that they wish to cover under the health plan, as well, they have two options: Self Plus One covers an additional eligible family member, such as a spouse or child; and Self and Family covers multiple additional eligible family members, such as a spouse and children. The Self Plus One option is new as of 2016. All three options carry different premium costs, with the Self-only premium being the least expensive and the Self and Family generally being the most expensive. Eligible family members include spouses and children up to age 26.

[3]Blue Cross and Blue Shield Association (BCBSA) administers the Service Benefit Plan, also known as the Federal Employee Program, on behalf of the independent Blue Cross and Blue Shield Plans to offer uniform benefits and rates across the country in the FEHBP through the Standard Option and Basic Option plans, hereafter referred to as the BCBS Standard and Basic plans. Some BCBS plans also offer local health maintenance organization plans in the FEHBP in their limited service area; BCBSA does not administer these local offerings.

as the basis of the calculation for the age and gender adjustment.[4] This report examines

1. the benefits and limitations of using FEHBP BCBS Standard plan data as the basis of the age and gender adjustment and alternatives to these data that could be considered; and
2. how any limitations of the BCBS Standard plan data could be mitigated.

To assess the benefits and limitations of using the BCBS Standard plan data, as well as to identify alternatives, we reviewed relevant statutory provisions and the Internal Revenue Service's (IRS) 2015 notices related to the age and gender adjustment, as well as other agency documentation and federal internal control standards.[5] We also reviewed comment letters submitted by stakeholder groups to IRS in response to its notices related to the age and gender adjustment. In addition, we interviewed knowledgeable officials from IRS, the Office of Personnel Management (OPM), the Department of the Treasury, and two agencies within the Department of Health and Human Services (HHS)—the Agency for Healthcare Research and Quality and the Centers for Medicare & Medicaid Services. We also interviewed industry and actuarial experts from the American Academy of Actuaries, BCBSA, the Employee Benefit Research Institute, the Health Care Cost Institute, the Kaiser Family Foundation, the National Association of Insurance Commissioners, and the Society of Actuaries to obtain their perspectives on the BCBS Standard plan data and alternative options.

To assess how limitations of the BCBS Standard plan data might be mitigated, we analyzed 2010 and 2015 FEHBP cost and enrollment data provided by OPM, as well as Current Population Survey (CPS) data available through the U.S. Census Bureau and the Bureau of Labor Statistics. We compared BCBS Standard plan contract holder demographics, by age and gender, with those of the national workforce

[4]Pub. L. No. 114-113, div. P, tit. I, § 103, 129 Stat. at 3037.

[5]See IRS, *Section 4980I—Excise Tax on High Cost Employer-Sponsored Health Coverage,* Notice 2015-16 (2015); IRS, *Section 4980I—Excise Tax on High Cost Employer-Sponsored Health Coverage,* Notice 2015-52 (2015); and GAO, *Standards for Internal Control in the Federal Government*, GAO-14-704G (Washington, D.C.; September 2014). Internal control is a process effected by an entity's oversight body, management, and other personnel that provides reasonable assurance that the objectives of an entity will be achieved.

according to CPS data, as well as to those of the BCBS Basic plan—the other national FEHBP plan offered by BCBS. We also modeled the impact of using various approaches for constructing the age and gender adjustment. Specifically, we identified a hypothetical employer scenario that should plausibly receive the age and gender adjustment.[6] We then constructed the age and gender adjustment for this hypothetical workforce using an approach outlined in IRS's notice. We assessed the reliability of these data by interviewing knowledgeable officials, reviewing related documentation, and performing data checks. On the basis of these steps, we concluded that the OPM and CPS data were sufficiently reliable for the purposes of this report.

We conducted this performance audit from July 2016 to September 2017 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

Excise Tax on High-cost Employer-sponsored Health Insurance

PPACA's excise tax on high-cost employer-sponsored health insurance is imposed when the value of employees' health coverage exceeds a threshold, referred to as the tax's applicable dollar limit. The applicable dollar limit was established in statute for 2018, the year the tax was originally to be implemented. PPACA stipulated that for 2019, the applicable dollar limit would increase by the amount of the Consumer Price Index for All Urban Consumers (CPI-U), plus an additional 1 percent.[7] Starting in 2020, the applicable dollar limit would then increase in step with the CPI-U each year thereafter. The Consolidated

[6]The hypothetical scenario we used was a workforce that is, on average, older than the national workforce.

[7]The CPI-U is an estimate of the changes in prices paid by urban consumers, also known as inflation, published by the Bureau of Labor Statistics.

Appropriations Act, 2016 delayed the tax's implementation until 2020.[8] Some economists have noted that because health care premiums have historically outpaced the CPI-U, it can be expected that the share of employers impacted by the tax should grow over time.[9]

The basis for determining the value of employees' health coverage that is measured against the applicable dollar limit of the tax—referred to as applicable coverage—is defined in statute. Applicable coverage includes both the employer's and the employee's pre-tax contributions to the premium for a group health plan and to a flexible spending arrangement, Archer Medical Savings Account, health savings account, or health reimbursement arrangement.[10] The amount of an employee's applicable coverage that exceeds their applicable dollar limit—known as the excess benefit—is subject to the tax. Because applicable coverage can vary by employee, for example, depending on whether or not they chose to contribute to a flexible spending arrangement or health savings account, the tax is determined separately for each employee. As a result, the tax could be owed for some employees and not others.

[8]The Congressional Research Service estimated that in 2020, these dollar limits would be around $10,800 for self-only coverage and $29,100 for other than self-only coverage. See Congressional Research Service, *Excise Tax on High-cost Employer-Sponsored Health Coverage: In Brief*, CRS 7-5700 (Washington, D.C.: Mar. 24, 2016).

In the 115th Congress, the House and Senate considered legislation that would further delay the tax or repeal the tax; however, as of August 25th, such legislation had not been enacted.

[9]For examples, see Joseph R. Antos, American Enterprise Institute, *Reforming the Tax Treatment of Health Insurance*, *Statement before the House Ways and Means Committee* (Apr. 14, 2016), 4 and Brookings Institution and Urban Institute, *Research Report: Building a Better "Cadillac"* (January 2017), 6.

[10]These various types of accounts allow employees and, in some cases, their employers to set aside pre-tax dollars, which can be used to cover health care costs not covered by their health plan.

Age and Gender Adjustment

The age and gender adjustment is designed to make the applicable dollar limit—the threshold for the tax—higher for employers with workforce demographics that are typically costlier than average.[11] Specifically, the law stipulates that the age and gender adjustment would increase the applicable dollar limit by an amount equal to the excess of a) the premium cost of the BCBS Standard plan, if priced for the age and gender characteristics of all employees of an employer, over b) the premium cost of the BCBS Standard plan, if priced for the age and gender characteristics of the national workforce.[12] In 2015, the IRS released a notice outlining a draft proposal for how the age and gender adjustment might be implemented.[13] The notice proposed using BCBS Standard plan premium and claims cost data (including claims costs classified into 5-year age and gender groups), as well as CPS national workforce data, to produce published tables that an employer could use to calculate its age and gender adjustment based on its specific workforce data. In its notice, IRS asked for comments on whether the calculation of group costs should rely on actual claims data from the BCBS Standard plan or, as an alternative, on "national claims data reflecting plans with a design similar to that of the [BCBS Standard plan]."

FEHBP

FEHBP provides health care coverage to federal employees, retirees, and their dependents through health insurance carriers that contract with OPM. In 2015, FEHBP provided an estimated $47.9 billion in health care benefits to roughly 8.2 million individuals, according to agency officials. Carriers offer plans in which eligible individuals may enroll to receive health care coverage. For the 2015 plan year, FEHBP options included fee-for-service plans that were available nationwide, plans available only to certain types of federal employees (e.g., postal workers), and plans offered by health maintenance organizations that were available only in certain regions. Of these plans, some were high-deductible plans and

[11]The law stipulates that the age and gender adjustment only applies if it increases the applicable dollar limit—it never decreases the limit. The law also provides for other adjustments to the applicable dollar limit. Specifically, the applicable dollar limit is increased by a specified amount for qualified retirees and for each of an employer's employees where a majority of its employees covered by the plan are engaged in high-risk professions, such as law enforcement officers and fire protection employees or those involved in the repair or install of electrical or telecommunications lines.

[12]26 U.S.C. § 4980I(b)(3)(C)(iii)(II).

[13]See IRS 2015-52.

consumer-driven plans.[14] Generally, individuals are able to choose from several plans, but most FEHBP contract holders were in plans offered by the BCBSA. In addition to offering the Standard plan, BCBSA also offers the Basic plan, and combined, these two plans are among the most popular of FEHBP plans.[15]

Experts Cited Benefits and Limitations of the FEHBP BCBS Standard Plan Data and Identified Alternative Data Sources, Which Also Have Limitations

The BCBS Standard plan has many characteristics that experts cited as important when considered for use as the basis of the age and gender adjustment. However, they also noted that it has limitations because it is not fully representative of the national workforce, has selection bias, and has experienced declining enrollment in recent years. Experts identified alternative cost data sources, but these data sources also have limitations. Some experts also expressed concern with the use of a premium value as the basis for the adjustment and suggested alternative approaches.

Experts Noted That the BCBS Standard Plan Is a Large and Convenient Source of Cost Data, but Underlying and Changing Member Demographics Limit Its Strengths

According to industry and actuarial experts we interviewed and stakeholders that commented on IRS's notices for the age and gender adjustment, BCBS Standard plan data have several benefits when considered for use as the basis of an age and gender adjustment, as stipulated in the law. Specifically, it is a large dataset that includes several years of data and is readily available (convenient). Experts we spoke with identified these as important characteristics for cost data that is to be used as the basis of an age and gender adjustment. Specifically, experts noted that the data source should have the following characteristics:

[14]Although they may differ in the specific benefits they provide, all FEHBP plans cover basic hospital, surgical, physician, emergency, and mental health care, as well as childhood immunizations and prescription drugs.

[15]The Standard plan is a preferred provider organization that charges members with a combination of copayments, coinsurance, and a deductible. Members are able to seek care outside of the provider network but at a higher cost. The Basic plan, also a preferred provider organization, has lower premiums and no deductible, but its copayments are higher and it does not cover services provided by out-of-network providers.

- **Be representative.** Several experts noted that the data source should reflect the demographics of the broader U.S. population, the national workforce, or the population eligible for employer-sponsored insurance, to the extent possible. Differences in the demographics between the broader population and the data source used for an adjustment could have an impact on health care costs and utilization and, thus, have an impact on the adjustment.
- **Be large.** Several experts pointed out that an ideal data source would be large, in terms of the number of individuals covered, in part due to the fact that there needs to be sufficient data within each of the age and gender groups.
- **Contain several years of data.** Some experts pointed out the benefit of using a data source that has been in existence for some time and that has several years of data so that one would have confidence that the data for a given year are not unusual.
- **Be convenient.** For the purposes of the government's use, several experts also noted that convenience of the data source could be important to consider—such as the ease with which the government can access and use the data and the costs for obtaining them.

Notably, the data from the BCBS Standard plan meet several of these characteristics because the plan is large, relatively popular, and covered just over 3 million members across the United States in 2015, making it the FEHBP plan with the highest enrollment. It is also a mature plan that has been in existence since 1959. Finally, it is convenient in that it is already available and familiar to the federal government, and BCBSA already provides summary cost and enrollment data to OPM on an annual basis.

However, experts and stakeholders identified two important limitations to using BCBS Standard plan cost data as the basis of an age and gender adjustment: 1) not being representative of the national workforce due to selection bias and 2) declining enrollment.

Selection bias. Enrollment in the BCBS Standard plan is affected by selection bias among the FEHBP options that may result in it not being representative of the national workforce. Within the FEHBP, federal employees can choose among many different health plan options. The BCBS Standard plan is a relatively expensive plan within the FEHBP and covers older and sicker members compared to other, less expensive plans, such as the other nationwide BCBS FEHBP option, BCBS Basic. Actuarial experts also noted that the BCBS Standard plan may be less

attractive to healthier individuals and younger families who may be more attracted to the FEHBP health maintenance organization options, including high-deductible and consumer-driven plans, or the BCBS Basic plan. Officials from OPM noted, and our review of two years of cost data confirm, that members in the BCBS Standard plan generally have higher health care costs than their counterparts in BCBS Basic and that this is particularly true for younger members. While other employers may offer more than one plan, most employers do not provide the number of options that the federal government provides, so selection bias among plans offered by other employers may be less extreme.

Experts and stakeholders noted that the selection bias within the FEHBP of more young members with higher health care costs in the BCBS Standard plan may result in an age and gender adjustment that is not adequate. For example, in part because the BCBS Standard plan disproportionately covers young members with higher health care costs, the ratio of the average claims costs of the older age groups to the average claims costs of the younger age groups is smaller than it would be in a plan that did not have that particular selection bias issue. As such, the ratios of costs for older age groups to costs for younger age groups would be understated compared to the ratios calculated based on data of a more representative population. If the claims cost data used for the adjustment had ratios that were understated in this way, then the adjustment based on these data might also be too small, for example, for employers with older demographics.

Some experts and stakeholders also noted selection bias in the FEHBP more broadly, in that its members, who include employees as well as retired former employees and their dependents, are not representative of the national workforce. For example, they noted that the federal workforce is skewed to a higher proportion of older workers than the national workforce. However, some experts we spoke with asserted that this may not be a limitation that would generally affect the use of FEHBP data for the age and gender adjustment because relative costs between older and younger employees in the federal workforce are likely similar to those of the national workforce.

Declining enrollment. In addition, while the BCBS Standard plan is large, it has experienced declining enrollment in recent years. Specifically, from 2010 through 2015, enrollment in the BCBS Standard plan decreased by over 10 percent. In contrast, enrollment in the BCBS Basic plan increased significantly from 2010 through 2015—a 46 percent increase in contract holders. (See table 1.) Notably, the cumulative

enrollment for the two BCBS FEHBP plans has been relatively stable over time. OPM officials noted that over time, this shift in enrollment from the Standard to the Basic plan may further exaggerate the demographic differences between Standard plan members and other populations, including the Basic plan and the general employed population. They also noted that it was possible that the BCBS Standard plan could continue to experience an enrollment decline, becoming more disproportionately skewed to older and higher-cost members. Finally, OPM, IRS, and Treasury officials all noted that any one plan offering could be discontinued. For example, in 2002, BCBSA merged its High Option plan in FEHBP with the Standard plan and added the Basic Option plan.

Table 1: Information on Changes in the Number of Federal Employees Health Benefits Program (FEHBP) Blue Cross and Blue Shield (BCBS) and Other Plan Contract Holders with Any Coverage Type, 2010 and 2015

Plan	Number of contract holders 2010	Number of contract holders 2015	Percentage of all FEHBP contract holders, 2015	Percentage change in contract holders from 2010 through 2015
BCBS Standard plan	1,859,312	1,650,432	41.8	-11.2
BCBS Basic plan	620,100	907,752	23.0	46.4
Total BCBS	**2,479,412**	**2,558,184**	**64.8**	**3.2**
Total all FEHBP plans	**4,023,883**	**3,947,826**	**100.0**	**-1.9**

Source: GAO analysis of data provided by the Office of Personnel Management. | GAO-17-661

Note: Contract holder counts include employed and retired contract holders, regardless of coverage type, from the 50 states and the District of Columbia.

Experts Identified Potential Alternative Data Sources; However, Those Data Sources Also Have Limitations

Experts cited other potential cost data sources, but each of these sources also has limitations. These sources and their limitations include the following:

- The Agency for Healthcare Research and Quality—a research agency within the HHS—maintains Medical Expenditure Panel Survey data collected through its annual survey, which contains cost information based on respondent recollection and provider reported data. According to agency officials, its 2014 dataset includes information on over 7,500 employer-sponsored insurance contract holders. While these data are grounded in a nationally representative probability sample and include the years 1996 to present, the survey's relatively smaller size may prove to be a limitation when classified into the necessary age and gender groups. Agency officials noted that several years of data could be pooled to ameliorate this issue.

- Blue Health Intelligence—an independent licensee of BCBSA—maintains data from many, but not all, BCBS plans across markets. Its dataset is large; however, because the members covered in the data only include BCBS members, it is not known whether the data are representative of national demographics. In addition, using these data would likely require contracting with Blue Health Intelligence for proprietary data, making this option potentially inconvenient.
- The Health Care Cost Institute (HCCI)—a research institute—maintains claims data from plans offered by Aetna, Humana, Kaiser Permanente, and UnitedHealthcare.[16] According to HCCI representatives, its most recent year of data covers over 40 million employer-sponsored members. HCCI's dataset is large and includes the years 2007 to 2015, but it is not known whether the data are representative of the national workforce. HCCI representatives told us that the data contain members in all 50 states and the District of Columbia, but some states have lower counts of members. They also noted that the data can be adjusted through weighting to make them more representative. However, as of June 2017, HCCI data did not contain information from BCBS plans, which represent the majority of enrollment in the insurance market in many states. In addition, it is not possible to identify costs by coverage type, such as self-only, which is needed to calculate the age and gender adjustment.
- Truven Health Analytics, an IBM company (Truven) is a healthcare data and consulting company that maintains the MarketScan claims database. According to Truven representatives, its 2015 dataset covers claims from 28.5 million members across its various clients and includes data mostly from large employers with self-funded health plans. Truven's MarketScan dataset is large and goes back to 1995, but Truven's data are comprised of a convenience sample—data collected from organizations that happen to be clients of Truven—and it is not known whether the data are representative of the national workforce. Truven representatives told us that the data contain members in all 50 states, but some states have lower counts of members. They also noted that the data can be adjusted through weighting to make them more representative. In addition, using Truven data would likely require contracting with Truven for proprietary data, making this option potentially inconvenient.

Because these alternative data sources also have limitations, coupled with benefits identified related to the BCBS Standard plan, some experts

[16]HCCI data included cost data from the above contributors as of June 2017.

stated that, while imperfect, the BCBS Standard plan is a fairly reasonable option for the basis of the age and gender adjustment. However, because of its noted limitations, its use could result in adjustments to the tax threshold that are not as effective as they could be for certain employers—in particular, for employers with older employees.

Some Experts Cited Concerns about how Premiums Might Be Used in Determining the Adjustment Amount

Some experts we interviewed and stakeholders that commented on IRS's notices for the age and gender adjustment raised concerns about tying an adjustment to a premium value. As stipulated by PPACA, the age and gender adjustment would increase the applicable dollar limit by

"…an amount equal to the excess of aa) the premium cost of the [BCBS Standard plan], if priced for the age and gender characteristics of all employees of the individual's employer, over bb) the premium cost of the [BCBS Standard plan], if priced for the age and gender characteristics of the national workforce."[17]

This could be achieved by establishing a dollar value for the adjustment by taking an employer-specific premium cost and subtracting a national premium cost, both priced using the BCBS Standard plan costs applied to the national and employer-specific workforces, respectively. This would create a specific dollar difference that would represent the adjustment for that employer. It could also be achieved by creating an adjustment factor by taking the percentage difference of these employer-specific and national premium costs.

Two actuarial experts and one industry expert we spoke with suggested that a percentage difference approach would be more appropriate than a dollar difference approach. Specifically, one actuarial expert contended that the value of the adjustment could be distorted if the value of the BCBS premium cost in any given year was unusually high or low. In either year, the percentage difference between costs priced for the national workforce compared to the employer's workforce should be the same (assuming no changes to the workforce makeup), but the dollar difference would not be the same. (See table 2.)

[17]26 U.S.C. § 4980I(b)(3)(C)(iii)(II).

Table 2: Hypothetical Example of Dollar and Percentage Difference Approaches to Implement the Patient Protection and Affordable Care Act's Age and Gender Adjustment Using Blue Cross and Blue Shield (BCBS) Standard Plan 2015 Cost Data for Self-Only Coverage

	Year with unusually low BCBS premium costs	Year with unusually high BCBS premium costs
Hypothetical BCBS Standard plan premium costs	$6,500	$11,300
Hypothetical premium cost priced for the national workforce	$5,286	$9,190
Hypothetical premium cost priced for the employer's workforce	$6,001	$10,432
Dollar difference	$715	$1,242
Percentage difference adjustment factor	13.5 percent	13.5 percent

Source: GAO analysis of Internal Revenue Service notice and data provided by the Office of Personnel Management. | GAO-17-661

Notes: We used IRS's notice as the basis for computing the age and gender adjustment amounts in this table, based on discussions with agency officials. The adjustment factors in this table are the percentage difference of the underlying employer-specific and national premium costs. We calculated these age and gender adjustment amounts and factors based on 2015 self-only cost data for employed contract holders in the BCBS Standard plan. The data used reflect the costs paid by BCBS and do not include employee out-of-pocket costs. The dollar difference amounts represent how much the applicable dollar limit would be increased for a hypothetical employer using the dollar difference approach. The adjustment factors represent how much more expensive the hypothetical employer's health costs are expected to be compared to those of the national workforce.

If a percentage difference approach were used, the adjustment factor created through this approach would need to be converted to a dollar value to determine a specific adjustment amount. All three experts who suggested this approach noted that the adjustment factor could simply be applied to the tax's applicable dollar limit, which will increase over time in line with the CPI-U. A similar approach could be to apply the adjustment factor to a portion of the tax's applicable dollar limit, for example, a portion estimated to represent health premium costs, excluding estimated costs associated with other health benefits such as flexible spending arrangements or health savings accounts. Another approach could be to apply the adjustment factor to a value that represents actual health care costs, such as an estimated average employer-sponsored premium, which would increase over time in line with health care inflation.

We note that the decision on what to apply the adjustment factor to when using a percentage difference approach would be dependent on the policy goal:

- **Limit the rate of growth of the adjustment value to general inflation.** If the adjustment factor were applied to the applicable dollar limit for the tax year or a portion of that limit, then the adjustment dollar amount would be expected to increase somewhat more slowly over time than it would if it were tied to an amount representing actual

health care costs, which would rise at the steeper rate of health care inflation. This could be preferable if the policy goal were to limit the rate of growth of the adjustment dollar amount to a rate lower than the typical health care inflation rate.

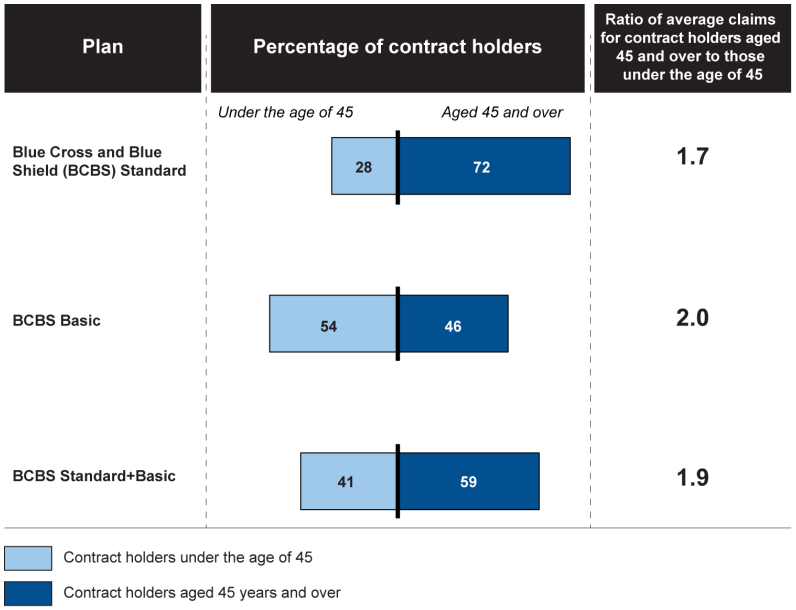
- **Keep the rate of growth of the adjustment value in line with health care inflation.** If the policy goal were to allow the adjustment dollar amount to increase in step with health care inflation, then it would be preferable to tie the adjustment to an amount representing employer-sponsored health plan costs.

The number of employers who received the age and gender adjustment that became subject to the tax would increase more quickly over time if the adjustment were tied to the applicable dollar limit that increases with the CPI-U than it would if tied to an amount representing health care costs.

Combining Premium Cost Data from Multiple FEHBP Plans Could Mitigate Standard Plan Data Limitations

Combining data from multiple FEHBP plans could mitigate some of the limitations of sole reliance on the BCBS Standard plan data as the basis for the age and gender adjustment, including concerns regarding selection bias. Several experts and stakeholders who commented on IRS's notices suggested this approach. They noted that combining data from multiple FEHBP plans, such as data from the BCBS Standard and Basic plans, could mitigate concerns. They specifically said that an adjustment based on data from the BCBS Standard plan alone may not be adequate due to the plan's selection bias within the FEHBP, as previously discussed. The BCBS Standard plan is a relatively expensive plan within the FEHBP and covers members with higher health care costs compared to other less expensive plans, including the BCBS Basic plan. We found that combining the data from these two plans could mitigate this selection bias. Specifically, we found that the adjustment may be particularly affected by selection bias among young Standard plan contract holders with higher health care costs. In particular, combining 2015 data from these two plans increased the percentage of young contract holders, and also increased the ratio of the average claims costs of older contract holders to the average claims costs of younger contract holders. (See fig. 1.)

Figure 1: Percentages of Contract Holders and Ratio of the Average Claims Costs in Blue Cross and Blue Shield (BCBS) Standard, Basic, and Combined Standard and Basic Plans for Contract Holders With Self-Only Coverage Aged 45 and over Compared to Contract Holders under the Age of 45, 2015



Source: GAO analysis of data provided by the Office of Personnel Management. | GAO-17-661

Note: These data reflect ratios of costs for employed contract holders under the age of 75 enrolled in self-only coverage.

In addition to mitigating certain selection bias concerns, combining data from multiple FEHBP plans could address concerns regarding the BCBS Standard plan's declining enrollment.[18] Combining data from multiple FEHBP plans—such as the BCBS Standard and BCBS Basic plans—would result in a more stable underlying enrollment population, based on current enrollment trends. Our analysis of OPM data shows that increases in BCBS Basic plan enrollment exceeded declines in BCBS Standard plan enrollment, resulting in a net increase in combined enrollment. Specifically, the number of contract holders enrolled in BCBS Standard and BCBS Basic plans combined increased 3.2 percent from

[18]We note two specific concerns about the BCBS Standard plan's declining enrollment: (1) it indicates a potentially unstable underlying enrollment population, and (2) OPM officials noted that, over time, this shift in enrollment from the BCBS Standard to the BCBS Basic plan may reflect increased selection bias, which could result in greater demographic disparities between Standard plan enrollees and other populations.

2010 through 2015.[19] (See table 3.) In addition, combined contract holders accounted for 65 percent of all FEHBP contract holders. Some experts and stakeholders also suggested that combining data from more FEHBP plans could further improve the data, by capturing individuals who select other types of plans, such as health maintenance organizations or high-deductible health plans. However, we note that combining data from different plans would require appropriate actuarial adjustments to account for cost differences that result from benefit design and other differences among the plans.

Table 3: Number of Contract Holders with Any Coverage Type in Blue Cross and Blue Shield (BCBS) Standard and Basic Federal Employees Health Benefits Program Plans and Percentage Change, 2010 and 2015

Plan	Contract holders 2010	Contract holders 2015	Percentage change in contract holders from 2010 through 2015
BCBS Standard	1,859,312	1,650,432	-11.2
BCBS Basic	620,100	907,752	46.4
Total BCBS	**2,479,412**	**2,558,184**	**3.2**

Source: GAO analysis of data provided by the Office of Personnel Management. | GAO-17-661

Note: Contract holder counts include employed and retired contract holders, regardless of coverage type, from the 50 states and the District of Columbia.

Using combined FEHBP data as the basis for the age and gender adjustment to include a broader selection of younger members could result in a different adjustment that could increase the adjustment amount for some employers. For example, we calculated a hypothetical, illustrative adjustment amount using the BCBS Standard plan only, as well as using BCBS Standard plan data combined with BCBS Basic plan data. We did this for a hypothetical employer with a workforce that is, on average, older than the national workforce—an employer that would likely receive an age and gender adjustment—without making any actuarial

[19]Supplementing the BCBS Standard plan data with other FEHBP plan data could be a more convenient option for IRS in the near future. Specifically, OPM officials noted that their agency is developing an all-FEHBP plan claims database, to include data from plans of all types that may appeal to all types of consumers. OPM officials stated that this database was anticipated to become populated with data by the end of 2017. If data were pooled from plans with different benefit structures, the data may need to be adjusted to account for those different benefit structures and enrollee pools. For example, the data could be adjusted based on actuarial value or some other benefit or risk factor.

adjustments to the data.[20] We found that combining 2015 cost data for active federal government workers enrolled in the BCBS Standard and BCBS Basic self-only coverage plans resulted in a higher adjustment amount for the hypothetical employer than did an adjustment based on BCBS Standard data alone.[21] This also resulted in a higher percentage difference adjustment factor for the hypothetical employer. (See table 4.) According to our analysis, combining the BCBS Standard and BCBS Basic data resulted in an increase in the ratio between the average claims costs of the oldest and youngest groups, yielding higher age and gender adjustment amounts for our hypothetical employer.

[20]For this illustration, we combined the Standard and Basic plan cost data without any actuarial adjustment. In practice, combining the data could require an actuarial adjustment to account for cost differences that result from benefit design or other differences between the plans, which could result in different adjustments than those shown in this illustration.

[21]Under the law, the age and gender adjustment would be determined separately for those with self-only coverage and those with coverage other than self-only coverage, such as family coverage.

Table 4: Age and Gender Adjustment for Hypothetical Workforce Using Blue Cross and Blue Shield (BCBS) Standard Plan Data and Alternative, Combined Federal Employees Health Benefits Program (FEHBP) Data for Self-Only Coverage

	Age and gender adjustment amounts and factors based on BCBS Standard plan data and alternative, combined FEHBP data	
Hypothetical employer with workforce that is older than the national workforce	**BCBS Standard**	**Alternative, combined FEHBP data: BCBS Standard and Basic combined**
Adjustment amount based on dollar difference approach	$879	$966
Percentage difference adjustment factor	13.5 percent	16.6 percent

Source: GAO analysis of Internal Revenue Service notice and data provided by the Office of Personnel Management. | GAO-17-661

Notes: We used IRS's notice as the basis for computing the age and gender adjustment amounts in this table, based on discussions with agency officials. The adjustment factors in this table are the percentage difference of the underlying employer-specific and national premium costs. We calculated these age and gender adjustment amounts and factors based on 2015 self-only cost data for employed contract holders in the BCBS Standard and Basic plans. The data used reflect the costs paid by BCBS and do not include employee out-of-pocket costs. The adjustment amounts represent how much the applicable dollar limit would be increased for the hypothetical employer. The adjustment factors represent how much more expensive the hypothetical employer's health costs are expected to be compared to those of the national workforce. These calculations are illustrative. For this illustration, we combined the Standard and Basic plan cost data without any actuarial adjustment. According to OPM, the actuarial values of the Standard and Basic plans are very similar and the provider networks are identical. In practice, combining the data could require an actuarial adjustment to account for cost differences that result from benefit design or other differences between the plans, which could result in different adjustments than those shown in this table.

We found that different adjustment amounts could have an impact on the total amount of taxes owed for an employer's workforce depending on the number of employees to which the tax was applied. For example, the adjustment amounts could determine whether or not an employee's coverage is subject to the tax and, if the employee's coverage is subject to the tax, how much tax is owed. Using the previously presented hypothetical example of an employer with a workforce that is older, on average, than the national workforce can illustrate the potential impact. In this example, we compare the hypothetical tax owed for 100 similar workers employed by that employer to illustrate the difference in the total taxes owed depending on whether the data used as the basis for the age and gender adjustment are the BCBS Standard data alone or the combined BCBS Standard and Basic data. (See table 5.)

Table 5: Hypothetical Example of Differences in Taxes Owed for 100 Similar Workers Employed by the Same Employer, by Federal Employees Health Benefits Program Data for Self-Only Coverage

In dollars

	Blue Cross and Blue Shield (BCBS) Standard	Alternative, combined FEHBP data: BCBS Standard and Basic combined
A: Employee applicable coverage amount	11,500	11,500
B: Age and gender adjustment amount	879	966
C: Initial, unadjusted applicable dollar limit for the tax	10,200	10,200
D: Employee adjusted dollar limit for the tax (B + C)	11,079	11,166
E: Employee taxable coverage (A - D)	421	334
F: Tax paid for employee (40 percent of E)	168	134
G: Total taxes for 100 similar employees (F x 100)	16,840	13,360

Source: GAO analysis of Internal Revenue Service notice and data provided by the Office of Personnel Management. | GAO-17-661

Notes: We used IRS's notice as the basis for computing the age and gender adjustment amounts in this table, based on discussions with agency officials. We calculated the age and gender adjustment amounts based on 2015 self-only cost data for employed contract holders in the BCBS Standard and Basic plans. The data used reflect the costs paid by BCBS and do not include employee out-of-pocket costs. These calculations are illustrative. For this illustration, we combined the Standard and Basic plan cost data without any actuarial adjustment. According to OPM, the actuarial values of the Standard and Basic plans are very similar and the provider networks are identical. In practice, combining the data could require an actuarial adjustment to account for cost differences that result from benefit design or other differences between the plans, which could result in different outcomes than those shown in this table.

Standards for internal control suggest that effective information is vital for an entity to achieve its objectives. Although the current law specifies the use of premium cost data from the BCBS Standard plan, relying on BCBS Standard plan data alone does not provide IRS with the comprehensive information it may need to determine an appropriate and adequate age and gender adjustment. Because the Consolidated Appropriations Act, 2016 delayed the implementation of the age and gender adjustment until 2020, an opportunity exists for IRS to consider options for mitigating the limitations of the BCBS Standard plan premium cost data. IRS and Treasury officials told us they are considering what flexibility they have under the statute to do so.

Conclusion

The age and gender adjustment was designed to increase the applicable dollar limit of the tax for employers with employees that are expected to be costlier than average so that taxes are owed based on the plan design and not based on member costs. Use of the BCBS Standard plan premium costs as the basis of the age and gender adjustment, as stipulated in the law, has certain limitations, primarily because of selection

bias. Further, data limitations may become more pronounced over time because the plan has been experiencing declining enrollment. Other potential data source options exist, but these options also have limitations. Combining data from multiple FEHBP plans could mitigate selection bias concerns, as well as any concerns about the future of the BCBS Standard plan alone. However, if data were pooled from plans with different benefit structures, the data may need to be actuarially adjusted. Nonetheless, because of its limitations, using the BCBS Standard plan data alone as the basis of the age and gender adjustment could result in an adjustment that is not as effective as it could be at increasing the applicable dollar limit for employers with costlier than average employees.

Recommendation for Executive Action

We recommend that, in implementing the age and gender adjustment, the Commissioner of Internal Revenue consider taking steps to mitigate the limitations of the BCBS Standard plan premium cost data—such as by combining data from multiple FEHBP plans. If combining the costs of plans with different benefit structures, the Commissioner should consider whether an appropriate actuarial adjustment should be used. If the Commissioner interprets that the statute does not provide the flexibility to mitigate the limitations of the BCBS Standard plan premium cost data by combining data from multiple sources or by other means, we recommend seeking that authority from Congress.

Agency Comments and Our Evaluation

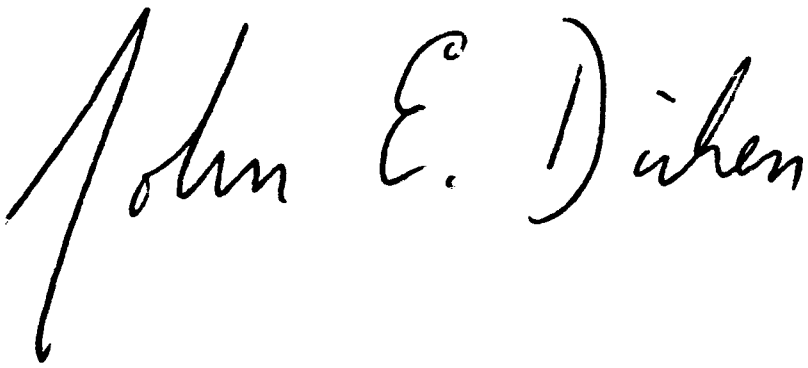
We provided a draft of this report to IRS and OPM for review and comment. The draft report was also reviewed by Treasury. Subsequent to reviewing the draft, IRS and Treasury officials contacted us to share some of their concerns with the wording of the recommendation related to combining claims costs of multiple health plans with varying designs. As a result of these discussions, we clarified our recommendation language so that it more explicitly focused on the need to mitigate the limitations of the BCBS Standard plan data. We continue to believe that it is worthwhile to consider using cost data from multiple FEHBP plans, but, as we note in the report, if this is done, an actuarial adjustment should be considered. We then shared the clarified recommendation language with the agencies.

We later received written comments from IRS, which are reproduced in appendix I. We also received technical comments on the draft from both IRS and OPM, which we incorporated as appropriate. We did not receive additional comments from Treasury. In its written comments, IRS neither agreed nor disagreed with our recommendation, but stated that it would

consider the recommendation as it continues to review comments received in response to an agency notice and work with the Department of the Treasury to issue guidance on the age and gender adjustment.

We are sending copies of this report to the Commissioner of Internal Revenue and the Acting Director of the Office of Personnel Management. In addition, the report is available at no charge on the GAO website at http://www.gao.gov.

If you or your staff have any questions about this report, please contact me at (202) 512-7114 or dickenj@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made key contributions to this report are listed in appendix II.



John E. Dicken
Director, Health Care

Appendix I: Comments from the Internal Revenue Service

COMMISSIONER

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

July 14, 2017

John E. Dicken
Director, Health Care
U.S. Government Accountability Office
441 G Street, N.W.
Washington, DC 20548

Dear Mr. Dicken:

Thank you for the opportunity to comment on the proposed report titled, *AFFORDABLE CARE ACT: Cost Data from Multiple Sources Could Improve the Age and Gender Adjustment for the Tax on High-Cost Health Plans* (GAO-17-661). Your study, required under section 103 of the Consolidated Appropriations Act, 2016, reviewed the suitability of using the Blue Cross Blue Shield (BCBS) Standard Plan, under the Federal Employees Health Benefits Program (FEHBP), premium cost as the basis for the age and gender adjustment under Internal Revenue Code (IRC) section 4980I.

We appreciate the time your team spent on the study. We reviewed your recommendations on using additional data sources for the age and gender adjustment. In the report, GAO recommends that the Commissioner of Internal Revenue consider (i) taking steps to mitigate the limitations of the BCBS Standard Plan premium cost data, such as by combining data from multiple FEHBP plans, and (ii) whether an appropriate actuarial adjustment should be used if combining different benefit plan costs.

In Notice 2015-52, 2015-35 I.R.B. 227, we requested comments on an alternative approach that would rely on national claims data reflecting plans with a design similar to the BCBS Standard Plan as the basis for the age and gender adjustment, and not on actual claims data from the BCBS Standard Plan. As you know, we received numerous comments in response to the notice. We will continue to review those comments, as well as your recommendations, as we work with the Department of the Treasury to issue guidance under IRC section 4980I.

If it is determined that a particular approach to mitigating the limitations of the BCBS Standard Plan data is the preferred approach, but that preferred approach is not available under the statutory provisions, we will consult with the Department of the Treasury on the advisability of seeking a legislative change to IRC section 4980I permitting implementation of such an approach.

If you have any questions regarding this letter, please contact Victoria A. Judson, Associate Chief Counsel, Tax Exempt and Government Entities, at 202-317-6000.

Sincerely,

John A. Koskinen

cc: Geri Brennan, Assistant Director

Appendix II: GAO Contact and Staff Acknowledgments

GAO Contact

John E. Dicken, (202) 512-7114 or dickenj@gao.gov

Staff Acknowledgments

In addition to the contact named above, Gerardine Brennan (Assistant Director), Kate Nast Jones (Analyst-in-Charge), Barbara Hansen, and Laurie Pachter made key contributions to this report. Also contributing were Sandra George, Emei Li, Vikki Porter, Jennifer Rudisill, and Jennifer Stratton.