



ZA-6

CC Jos
A.

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

PRIME MINISTER

NHS REVIEW: TAX RELIEF

file with PC
As requested, I attach a paper, for discussion at our meeting on 7 June, on two possibilities:

- exemption from tax as a benefit in kind of premiums paid by employers under company schemes; and
- tax relief for private medical insurance premiums paid by the elderly.

The paper shows that any relief for employees in company schemes would be unlikely to prove cost effective; and it would lead to pressure, which in my view would be very hard to resist, to do something for other employees and the self-employed - not to mention tax incentives in other areas, for which there is considerable pressure.

More generally, these schemes tend to share the disadvantages of contracting out which I addressed in my minute of 22 April; helping those who can already afford private health insurance and at the end of the day failing to deliver a net increase in private sector provision.

My conclusion is therefore that, if we are to do anything in the way of encouraging private medical insurance through the tax system, it should be confined to the second option. While in general our tax policy is one of the lowest possible rates on the broadest possible base, tax relief for the elderly could be presented as a

B.



well-targeted special case designed in particular to help people stay in insurance schemes at the point where at present they tend to be priced out.

I am copying this minute, and attachment, to John Moore, Tony Newton, Sir Robin Butler and Sir Roy Griffiths.

Moir Wallace

PP

[NL]

3 June 1988

(Approved by the Chancellor
and signed in his absence)

TAX RELIEF FOR PRIVATE MEDICAL INSURANCE

Note by the Chancellor of the Exchequer.

1. At the meeting on 9 May I agreed to provide a paper on two possibilities identified by the Group: tax exemption for employees on premiums paid by employers under company schemes; and tax relief on premiums paid for private medical insurance for the elderly.

Benefit-in-kind exemption

2. I have looked at the case for exempting from taxation, as a benefit-in-kind in the hands of the employee, premiums paid by employers under a company scheme.

3. Company schemes covering employees are already growing quite satisfactorily - in recent years the number of employees covered has been rising at about 3 per cent per year. *Curve has flattened.*

no

4. One factor is this growth in undoubtedly the fact that there is already a substantial fiscal incentive for employers to introduce such schemes. As compared with a corresponding amount of cash pay, the employer saves NIC - at 10.45 per cent - on the cost of the premium. And where the employee is below the Upper Earnings Limit, there is also a saving of his own contribution - up to 9 per cent.

5. This growth in employer schemes means that a tax exemption would have a considerable deadweight cost - some £80 million, and rising. And its effectiveness in expanding cover could be very speculative, since the incentive would be indirect - the employee's tax position would be improved, but not the position of the employer who has to pay the premium. It is most unlikely that the overall effect of a scheme of this kind would be other than a net reduction in private spending on health care once the cost of the tax relief is taken into account.

6. Moreover, while a benefits-in-kind exemption would build on the existing success of company schemes, it would be extremely difficult to justify limiting a tax relief in that way, because it would put employees lucky enough to have a company scheme at a (further) advantage compared with everyone else who paid for their own insurance - not merely other employees, but also the self-employed. And it could have wider repercussive effects, with pressure to exempt other "worthy" benefits in kind (such as workplace nurseries).

7. My conclusion is that this proposal is unlikely to be good value for money and it would be very difficult to defend the discrimination, which it necessarily implies, in favour of employees in the big company schemes and against other employees and the self-employed.

Tax Relief for the Elderly

8. These difficulties are not so evident with a relief for the elderly. The elderly are heavy users of health services. At the same time, they are less likely to be covered by private medical insurance than the population as a whole.

9. The reasons for the low coverage are:

- In the past, insurers have been reluctant to provide cover for new subscribers over 65. (However, BUPA have recently introduced a new scheme, albeit with fairly limited cover, for new subscribers up to 75).
- The price of insurance, even for existing subscribers, rises sharply from age 65 onwards.

And the restrictions in the cover tend to bite harder on the elderly than on others.

- Some of the major requirements of the elderly (eg for long-term care) are not at present insurable on any terms.

10. The combination of these factors means that the elderly represent a very heavy call on NHS resources. Many of those with private medical insurance drop out on reaching retirement. The question is whether tax relief on their private medical insurance premiums would provide a practical, cost-effective and politically sustainable method of retaining them within the private sector for at least some of their needs, or even of attracting new elderly subscribers.

11. On the practicalities, a tax relief scheme for the elderly could be operated by the Revenue on the lines of the MIRAS scheme for mortgage interest relief. That is, relief would be given to subscribers "at source", by reduction of the premium, with the Revenue reimbursing the insurance providers direct. The relief could best be targeted on those who find it difficult to afford medical insurance now, by making it available only at the basic rate of tax. And if the relief were to be made available on all qualifying policies where the person insured was over 60, regardless of who paid the premiums, people of working age might be encouraged to pay for their parents' insurance.

12. A number of detailed questions about exactly what policies would qualify for relief would need to be discussed by officials in the Inland Revenue and DHSS.

13. The cost-effectiveness of the relief would depend on the deadweight cost of giving relief to existing subscribers; and on the extent to which it encouraged existing subscribers to maintain their cover on reaching 60

(or attracted new subscribers, both under 60s and over 60s).

14. The deadweight cost of relief at basic rate only for the over-60's would be £25 million. The behavioural effect - the increase in the number of subscribers as a result of giving relief - is however very uncertain. If the increase was only marginal, then the extra money going into private health care would be less than the cost of tax relief. In that case, the relief would not represent a good buy. An increase of at least a third in the number of over-60s covered would be needed before we began to achieve "value for money" from the change.

15. While any view of the behavioural effect is necessarily uncertain, I believe there are some grounds for optimism, provided we do not take too short-term a view:

- As I have already noted, we need to take account of those currently under 60. Where they have cover now, they may be more inclined, with tax relief, to keep up their subscriptions after they retire. And those who do not have cover may be more inclined to start, if they feel that tax relief will mean they can afford to continue into old age.
- We are starting from a very low base. Since only 4 per cent of the over-60s have private medical insurance now, an increase of a third means only another 1.5 per cent of that age group.
- it is encouraging that BUPA have recently started offering cover, albeit restricted, for new joiners over 65; but for other schemes the maximum enrolment age is still normally 64 or less. If tax relief were given, DHSS should make clear to private insurers that it was now up to them to go out and get the business.

16. On the wider political implications, the introduction of this relief would, of course, be an exception to the general tax policy we have pursued - of reducing special reliefs for particular sorts of expenditure, and of cutting tax rates across the board, so as to leave people to make their own decisions about what they do with their money. If exceptions to this general rule are made, it is important that they can be tightly ring-fenced. A relief targeted on the elderly would be well understood and should not give rise to irresistible pressure for extension to other groups.

17. My conclusion, therefore, is that a scheme of tax relief for the over-60's - in contrast with a benefits-in-kind exemption - is practical, politically attractive and containable; and, while there is no guarantee that it will be cost-effective, there is some reason to be optimistic about the effect in the longer term.

NHS Exp & Eff Part 12

