Toward Equitable Financing of Green Mountain Care

Proposal by the Healthcare Is a Human Right Campaign

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www.healthcareisahumanright.org

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Introduction

When Vermont enacted its pioneering universal healthcare law in May 2011, it adopted a principled framework for designing and implementing the state's new public healthcare system, Green Mountain Care (GMC). The law – Act 48 – sets out parameters for the financing of GMC, while leaving the design of a financing plan to a separate process.

The Healthcare Is a Human Right Campaign supports a timely and participatory decision-making process about the financing of GMC. We submit these proposals as guidance for this process, and ask the Administration and Legislature to give them careful consideration.

The Healthcare Is a Human Right Campaign has developed these proposals through a collaborative analysis grounded in the human rights principles reflected in Act 48. These principles set clear standards for the design and implementation of Green Mountain Care.

- Financing must ensure **universal access** to comprehensive, appropriate care. Vermonters have a right to receive all the medically necessary care they need. Healthcare resources must match our health needs, not the other way around. The financing plan must be focused on care, not on saving money.

- The principle of **equity (of finance)** requires that the costs of financing the system be shared equitably, which means that richer people — and more profitable companies — should pay proportionately more into the healthcare system than poorer people.

- The principle of **equity (in access)** requires that everyone get the care they need when they need it, with no barriers to access created by co-pays, deductibles, premiums or a limited package of “benefits.”

1. Human rights principles in Act 48

Act 48 reflects the key human rights principles of universality and equity by stating explicitly that Green Mountain Care must be publicly financed, with sufficient funds to ensure universal access to comprehensive and appropriate care for all, and that this financing must be shared equitably.

> *The purpose of Green Mountain Care is to provide, as a public good, comprehensive, affordable, high-quality, publicly financed health care coverage for all Vermont residents in a seamless and equitable manner regardless of income, assets, health status, or availability of other health coverage.” (Subchapter 2. Green Mountain Care §1821)*
>
> *The financing of health care in Vermont must be sufficient, fair, predictable, transparent, sustainable, and shared equitably.” (18 V.S.A. § 9371, Section 1a: 11)*

Act 48 specifically applies the principle of equity as guidance for the Administration in the design of Green Mountain Care financing.

> *In developing both financing plans, the secretary shall consider the following:*
> *(2) [...] consistency with the principles of equity expressed in 18 V.S.A. § 9371 (Section 9, b).*

It follows that any financing plan for Green Mountain Care must meet the principles of universality and equity:

- The state must develop a publicly financed healthcare system in which all residents get the care they need and contribute what they can.

- The state must devise an equitable financing mechanism, with contributions based on the ability to pay (e.g. income, wealth, corporate profits), rather than on the use of needed care.

Guidance from international health and human rights institutions affirms the importance of the principles and criteria stated above. To ensure that a healthcare system truly meets key human rights principles, the World Health Organization recently issued new guidance for the development and assessment of health systems. It states that health financing mechanisms must support people's right to universal access to care, and that the "State must use maximum available resources and identify effective health financing mechanisms to ensure that health facilities, goods and services are accessible and affordable for all." [1] The UN Special Rapporteur on the Right to Health is even more explicit in his recent report to the UN General Assembly: "States unwilling to utilize the maximum of their available resources towards realization of the right to health are in violation of their obligations under the right."[2]

To meet the principle of equity, WHO guidance states that

> *Financial contributions to the health system need to be collected in ways that ensure that low-income households are not disproportionately burdened with health expenses as compared to richer households.*[3]

The UN Special Rapporteur outlines the concrete requirements entailed in principle of equity:

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[1] World Health Organization, *Human Rights and Gender Equality in Health Sector Strategies: How to Assess Policy Coherence*, Geneva 2011, available at http://whqlibdoc.who.int/publications/2011/9789241564083_eng.pdf; see also World Health Organization, *The World Health Report 2010: Health Systems Financing: The Path to Universal Coverage*, Geneva 2010, available at http://www.who.int/whr/2010/en/index.html

[2] UN General Assembly, *Interim Report of the Special Rapporteur on the Right of Everyone to the Enjoyment of the Highest Attainable Standard of Physical and Mental Health*, A/67/302, August 2012, p.5; available at http://daccess-dds-ny.un.org/doc/UNDOC/GEN/N12/461/01/PDF/N1246101.pdf?OpenElement

[3] Human Rights and Gender Equality, supra note 1.

> *The right to health approach to health financing requires that taxation to fund health be levied progressively in order to ensure equitable revenue generation. Progressive taxation requires taxpayers to contribute according to their ability to pay. For example, progressive income taxation requires wealthy taxpayers to contribute a higher percentage of their income than poorer taxpayers. In contrast, regressive taxation involves greater proportional contributions from those with less financial resources than from wealthier taxpayers. Regressive taxation is thus an inequitable financing mechanism for health and not in accordance with the right to health. [...] VAT, sin taxes and other forms of consumption taxes that are primarily regressive are not in accordance with the obligation of States to respect the right to health.*[4]

In the report's recommendations, "the Special Rapporteur urges States to take the following steps in order to ensure adequate funds are available for health: (a) Implement a progressively structured system of general taxation to fund health."[5]

The international legal framework thus offers concrete guidance for implementing the principles in Act 48.

2. Implementation Principles

The financing of GMC must be guided by the basic principles of equity and universality, as required by Act 48. How can those principles best be implemented in practice? The Healthcare Is a Human Right Campaign issued a detailed standards guide in 2010,[6] based on human rights principles. These standards set out concrete guidelines for the design and implementation of a universal healthcare system. In this proposal, we apply and expand those guidelines to a focus on financing. To achieve equity and universality in healthcare, the ten implementation principles below constitute the parameters for designing a financing plan.

- **Financing based on needs**: Financing of health services or "benefits" must be based on health needs, with resources allocated to match those needs. Resources must be sufficient to meet all healthcare needs that are medically necessary, and allocated in a way that does the most good for the health of the people of Vermont. To do that, the use of a specific benefits package should be avoided, as this tends to impose artificial restrictions on medically necessary care. Most countries with a universal system provide comprehensive "benefits" without specific definition (usually including preventive and public health services, primary care, ambulatory and inpatient specialist care, prescription pharmaceuticals, mental health care, dental care, rehabilitation, home care and nursing home care) and instead have a regulatory system that assesses the benefits and cost-effectiveness of specific interventions, equipment and drugs for the population as a whole.

[4] Special Rapporteur, supra note 2, p. 8.
[5] Id., p. 20
[6] http://www.workerscenter.org/assessment

- **Using existing resources effectively:** Vermont residents already pay significantly more for healthcare than people in countries with a universal healthcare system, so there is no need for new money. Instead, funds must be allocated differently and raised much more equitably. Additionally, where possible, federal funding sources should be pooled.

- **Public financing**: Vermont must treat healthcare as a public good for all, not as a market commodity. Public financing provides healthcare based on need rather than payment; in other words, it detaches payment from the use of care or the risk of illness. Public financing also takes waste and profit (or surplus revenue) out of the system. It is more cost-effective because a single public payer will be able to exercise greater purchasing power in negotiations with providers and pharmaceutical companies (like the VA currently does). Countries that rely heavily on private financing – either through private health insurance or through user fees – have poorer health outcomes yet incur higher costs than those primarily financed publicly.

- **Free at the point of service:** Funds for healthcare must be collected independently of a person's use of healthcare. Payments into the system must be made according to ability to pay, not according to the use of healthcare. This collective "pre-payment" means that when a person falls sick, no further payments are required. Evidence shows that even minimal cost-sharing leads to inequality in access to care and produces poorer health outcomes, while failing to increase cost-effectiveness or achieve cost control.[7] Instead, healthcare services must be paid for through a universal system, which shares costs and risks of needing care across the population.

- **Single pool of funds:** Funds for healthcare need to be pooled to maximize the stability of the payment fund and reduce costs. The larger the pool and the smaller the number of pools (ideally a single pool), the greater the equity of access, administrative efficiency, and mitigation of risks.

- **Progressive, tax-based financing**: Public healthcare financing through progressive taxation ensures that financial contributions are made according to ability to pay. Financing mechanisms that do not account for ability to pay (user fees and premiums) and are regressive (indirect taxes such as sales, consumption and sin taxes) should not have a role in healthcare financing.

- **Sufficient financing**: The level of healthcare financing must be determined by health needs; funds must be adequate to enable all people to access medically necessary care.

- **Stable financing:** The level of healthcare funds must not be subject to political or market vagaries. Funding must be consistent, according to long-term needs, not precarious and short-term.

[7] See the Healthcare Is a Human Right Campaign briefing on user fees: "Research evidence for adverse health effects of out-of-pocket costs ('cost-sharing')," March 2012.

- **Transparency & Accountability**: The people must know where the money for the healthcare system comes from, where it goes, and whether it is sufficient. They must be able to hold those managing the healthcare system accountable.

- **Participation:** Public spending and revenue decisions, including on healthcare, must entail a process of public participation, especially in determining whether the healthcare system is adequately funded to meet needs.

3. Public financing of healthcare

Healthcare is recognized as a public good in Vermont by statute. Act 48 requires Green Mountain Care to be publicly financed and provided as a public good to all. Healthcare must no longer be treated as a commodity, sold in the market to those who can afford it. Public financing is a precondition for ensuring that everyone has access to comprehensive care based on need rather than payment. Green Mountain Care is required to remove the market imperatives that for too long have taken precedence over health protection.

Overwhelming evidence from Vermont, the United States and around the world has shown that private, market-based healthcare systems produce poorer health outcomes, restrict access to care, and increase inequities in access and financing.[8] They also use resources less effectively and efficiently than public systems, and result in significantly higher costs to all payers.[9]

Markets limit access to care due to a range of factors, including payment, level and source of insurance coverage, and design of benefits packages. Commercialized healthcare systems rely heavily on private health insurance companies whose business model depends on limiting access to care in order to take surplus revenue or profit out of the system. Single public payers, such as Medicare, consistently show better performance in access, quality and outcome measurements, while also operating at significantly lower costs. As a public payer exercises greater purchasing power and removes incentives for overspending and inefficient models of care, it can distribute resources more equitably and more efficiently than a multitude of private payers. Countries that rely more heavily on private financing – either through private health

[8] UNRISD Research and Policy Brief, *Commercialization and Globalization of Health Care: Lessons from UNRISD Research*, Geneva 2007, available at http://www.unrisd.org/80256B3C005BCCF9/httpNetITFramePDF?ReadForm&parentunid=7C04740AD2852A4AC12573E6002E24DC&parentdoctype=brief&netitpath=80256B3C005BCCF9/%28httpAuxPages%29/7C04740AD2852A4AC12573E6002E24DC/$file/RPB7e.pdf

[9] A large body of evidence explains why the market-based U.S. healthcare system costs more than twice as much per capita than public healthcare systems elsewhere; see e.g. Woolhandler, S. et al. “Costs of Health Care Administration in the United States and Canada,” in: New England Journal of Medicine, August 2003; and why public insurance programs in the U.S. are significantly more cost-effective than private coverage; see e.g. Boccuti, Cristina and Marilyn Moon, “Comparing Medicare And Private Insurers: Growth Rates In Spending Over Three Decades,” in: Health Affairs 22:2, March/April 2003.

insurance or through higher levels of user fees – are also those that spend more on healthcare as a proportion of GDP.[10]

A publicly financed system is able to ensure that both costs and benefits are equitably shared. To do so, it must completely eliminate private, out-of-pocket payments from patients. User fees charged at the point of access to care (including deductibles and co-pays) are proven to be the most inequitable way of paying for healthcare.[11] Moreover, such fees pass on the costs of the health system to those who are sick and most in need of care. Instead, a publicly financed system must be fully pre-paid through direct taxes, thus collecting contributions based on ability to pay and independent from the use of healthcare. Evidence from comparisons of health systems in North America and Europe consistently illustrates that public financing is substantially more equitable than private financing.[12]

4. Proposed public financing mechanism for Green Mountain Care

The Healthcare Is a Human Right Campaign proposes to finance Green Mountain Care, Vermont's new universal healthcare system, primarily through the progressive and direct taxation of income and wealth, both individual and corporate, and through addressing loopholes and inequities in the current tax code. To ensure that contributions are based on "ability to pay," our proposal directs special attention to capturing income not related to payroll earnings, i.e. unearned income and wealth.

Income taxes are the most equitable financing mechanism

Taxes on income are direct and progressive taxes, which allow the equitable sharing of responsibility for financing the healthcare system based on people's ability to pay. Households with higher incomes pay proportionally more, and those with lower incomes pay proportionally less. Individual income taxes are applied to both earned income, e.g. wages, and unearned income, e.g. dividends and interests (capital gains are taxed differently, see below).

Evidence from comparisons of health systems in North America and Europe consistently illustrates that progressive income taxes are the most equitable mechanism to finance a

[10] Thomson, Sarah, Thomas Foubister, Elias Mossialos, *Financing Health Care in the European Union: Challenges and Policy Responses*, European Observatory on Health Systems and Policies, xxii-xxiii, available at http://www.euro.who.int/__data/assets/pdf_file/0009/98307/E92469.pdf.

[11] Wagstaff, Adam and Eddy van Doorslaer, "Equity in the Finance of Health Care: Some International Comparisons," in: Journal of Health Economics, 11, 361-387 (1992), available at http://repub.eur.nl/res/pub/11462/EquityInTheFinance_1992.pdf; See also: Van Doorslaer, Eddy and Adam Wagstaff, "The Redistributive Effect of Health Care Finance in Twelve OECD Countries," in: Journal of Health Economics, 18 (1999), 291–313.

[12] Id.; see also Financing Health Care in the European Union, supra note 10.

healthcare system.[13] Such taxes are used for the majority of healthcare financing in Canada, the UK, Italy, Ireland, Denmark, Spain and Sweden. Data shows that all of these countries, and particularly the UK and Italy, which rely most heavily on national income taxes, have greater equity in healthcare financing than countries with other financing mechanisms, such as payroll taxes.[14]

The study conducted for Vermont by Professor Hsiao concurs: "The most equitable, or progressive, form of health care financing is household income tax."[15]

Income taxes yield sufficient levels of funding

Using an income tax strategy to fund Green Mountain Care would create a higher revenue base than other mechanisms. In comparison with payroll taxes, incomes taxes yield higher receipts as they apply to a substantially larger amount of funds. In 2009, total adjusted gross income (AGI) in Vermont was $15 billion, whereas total Vermont payroll in 2010 (without federal employees who will continue to receive federal health insurance) was $11.1 billion.[16] Income tax would therefore be levied on an additional $3 billion, thus increasing the revenue available to Green Mountain Care.[17]

While state income taxes in Vermont are currently calculated on the basis of "federal taxable income," rather than AGI,[18] a shift toward AGI would have clear advantages. Vermont is only one of six states using federal taxable income, compared with 30 states that use AGI as a base.

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[13] See Equity in the Finance of Health Care, supra note 11, which concludes that tax financing, particularly through income tax, tends to be progressive, whereas payroll funded or social insurance systems are somewhat regressive, and private systems are even more regressive; see also Financing Health Care in the European Union, at xxiv, which points to the importance of capturing income not solely based on wages; see also Edith Rasell, "An Equitable Way to Pay for Universal Coverage," International Journal of Health Services, Volume 29, Number 1, 179–188, at 182, 1999.

[14] Equity in the Finance of Health Care, supra note 11, passim.

[15] Hsiao, William, K.T. Li, Steven Kappel, Jonathan Gruber, *Act 128: Health System Reform Design: Achieving Affordable Universal Health Care in Vermont* (2011), at 94, available at http://www.leg.state.vt.us/jfo/healthcare/FINAL%20REPORT%20Hsiao%20Final%20Report%20-%2017%20February%202011_3.pdf [hereinafter "Hsiao report'].

[16] For the purposes of levying an income tax specifically for Green Mountain Care, other population groups (beyond federal employees) that may continue to receive healthcare through other channels (e.g. Medicare and VA patients, etc.) may have to be excluded from these amounts, as they could be exempted from GMC taxes.

[17] Doug Hoffer, "Financing Single Payer: Let's Stick to the Facts," August 17, 2011, available at http://vermontforsinglepayer.org/blog/2011/08/financing-single-payer-let%E2%80%99s-stick-to-the-facts/.

[18] Using federal taxable income as a starting point for calculating state taxes provides a $10.2 billion revenue base, in contrast to $15 billon based on AGI. See 32 V.S.A. § 5824 (adopting federal income tax laws for determining Vermont tax liability).

By shifting the income tax base for Vermont to AGI, as recommended by the Blue Ribbon Tax Structure Commission,[19] the state could increase its revenue base.[20]

Additionally, the state can bring in a sizable amount of new revenue by fixing inequitable loopholes in its income tax system. Currently, Vermont taxes certain unearned income, including interest and dividends, at the same rate as earned income. However, it gives preferential treatment to capital gains, i.e. unearned income from the sale of capital assets, including stocks, bonds, real estate, and other investment property.[21] Roughly $31 million per year can be gained by repealing a tax break on capital gains and taxing this form of unearned income at the same rate as other income.[22] The existing preferential tax treatment is extremely inequitable, disproportionately benefiting the very wealthy, with $14 million of capital gains income attributable to those earning more than $1 million.[23] Vermont is one of only nine states that allows for this special treatment of capital gains; the principle of equity requires that this loophole be closed.

Wealth taxes can increase equity of healthcare financing

In the United States, taxes mostly target money at the point of flowing in or out of a person's possession, e.g. income and sales. Yet, taxes may also be directly applied to the assets that a person owns, outside the point of sale or even appreciation of value. This is the case with the real property tax in the United States, which targets the value of a person's land and

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[19] Final Report: Blue Ribbon Tax Structure Commission (2011), at 10, http://www.leg.state.vt.us/JFO/reports/2011%20Blue%20Ribbon%20Tax%20Structure%20Commission%20FINAL%20REPORT.pdf.

[20] Any federal deductions relevant to promoting equity and maximizing federal funding can be identified and specifically added back into the determination of the state income tax base. For example, a state income tax for healthcare could be declared deductible from federal taxes, so that it is treated favorably by federal taxation, just as employer-based insurance is now. However, both types of federal tax deductions disproportionately benefit higher income individuals, thus reducing equity.

[21] Present tax treatment of capital gains depends on the capital asset sold. Individuals and companies may exclude from taxation either the first $5,000 of "adjusted net capital gains" (ANCG), as defined by federal law, or 40% of ANCG from the sale of assets held for more than 3 years by the taxpayer. Principal residences, second homes, camps, cottages, ski condos and vacation properties (unless not used as a "home," as defined under federal law), "depreciable personal property" (e.g. motorized vehicles, boats, airplanes; trade fixtures or business equipment; construction and logging equipment), and publicly-traded stocks, bonds and other financial instruments can only claim the $5000 exclusion. 2012 Fiscal Facts, Vermont Legislative Joint Fiscal Office, at 33, available at http://www.leg.state.vt.us/jfo/publications/2012%20Fiscal%20Facts.pdf. See 26 U.S.C.A. § 1221 for the federal definition of "capital assets" for taxation purposes.

[22] Vermont Tax Expenditures 2011 Biennial Report, Vermont Department of Taxes and Legislative Joint Fiscal Office, at 21, available at http://www.state.vt.us/tax/pdf.word.excel/statistics/2011/expenditurereport2011.pdf.

[23] Id.

improvements thereon. Several countries in Europe, including France[24], Norway[25], and Switzerland[26], have gone much farther than the United States in applying their taxation power to the aggregate value of all household holdings, i.e. "net worth" or "purchasing power," of its wealthiest residents. For instance, France's "Solidarity Tax on Wealth" (Impôt de Solidarité sur la Fortune) applies a low tax-rate of 0.25 to 0.5% on the aggregate value of all of the assets, located anywhere in the world, of residents with over 1.3 million Euros.[27] This is considered a wealth tax, as it is more reliable at focusing on extreme wealth than any attempts to tax the flow of income. While it is likely to generate significantly more revenue at a national level than in a small rural state like Vermont, the introduction of such a tax could signal the commitment to increasing equity in the financing of Vermont's healthcare system.

Income taxes are a stable and sustainable source of funding

Receipts from income taxes are a stable and sustainable funding source, particularly compared to payroll taxes. While income tax receipts, along with most other tax receipts, fluctuate somewhat with economic cycles, they are less dependent on the population's employment rate than payroll taxes. In times of high structural unemployment, and with a long-term outlook of declining employment rates due to economic restructuring and demographic changes, the level of funds that can be collected through payroll taxes is likely to decrease and threaten the sustainability of a healthcare system. As a report published by the European Observatory on Health Systems and Policies states:

> *In the light of these contextual changes, it seems unlikely that any country would now seriously consider moving towards a more employment-based system of financing health care. Some of the countries that already have them – for example, France and Germany – have struggled with major deficits for several years.*[28]

Any financing mechanism requires flexibility and adaptability to address changing healthcare needs, variations in costs, or fluctuations in revenue receipts. It is crucial that the healthcare system is adequately funded at all times, guided by a participatory assessment of needs rather than dependent on political agendas. To ensure that tax rates are kept in line with healthcare needs and costs, an indexing mechanism could be developed. A set of indicators measuring needs could project required funding levels. Indexing would then allow tax rates to be increased or decreased through a regular, automatic adjustment (similar to cost-of-living adjustments), without legislative intervention, up to an agreed threshold. Additionally, a rate stabilization fund could be established to cover costs during economic downturns.

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[24] Lomas, Ulrika, French Wealth Tax Yields Surprising Revenues, Tax-News.com, Jan. 26, 2012, http://www.tax-news.com/news/French_Wealth_Tax_Yields_Surprising_Revenues____53674.html.

[25] Tax Facts Norway 2010: A Survey of the Norwegian Tax System, KPMG Law Advokatfirma Da (2011), at 40, available at http://www.kpmg.no/arch/_img/9585751.pdf.

[26] Taxation.ch, http://www.taxation.ch/index.php?id=20.

[27] Lomas, supra note 19.

[28] Thomson, supra note 7, at 53.

Strategies for ensuring that businesses pay their share

A role for corporate income taxes?

Corporate income taxes could, in theory, be the most equitable way to ensure that businesses pay according to their ability and size (rather than based on their hiring and wage practices). A review of corporate income tax receipts shows that big, multinational corporations pay the vast majority of corporate income taxes in Vermont, which indicates that those with the greatest ability to pay do indeed contribute the most.[29]

However, a closer look reveals that many corporations are not required to pay state corporate income tax at all, and those who are, often pay very little.

Over the past 10 years, tax receipts have shifted from corporate to individual income taxes[30] in part because of the increasing use of s-corporations, partnerships and limited liability corporations,[31] which are not subject to corporate income taxes. Instead, shareholders are taxed according to their portion of corporate profits on their individual income tax returns, and corporations pay a flat $250 per year for doing business in the state. Additionally, financial institutions[32] and insurance companies[33] are exempt from the corporate income tax, paying fixed tax rates on average monthly deposits and on premiums and assessments, respectively.

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[29] In 1996, 75 companies, the top 3%, account for 50% of corporate income tax receipts (the top 1% paid 37%), all of them multi-state or multi-national; Legislative Joint Fiscal Office, Vermont 1996 Tax Study, http://www.leg.state.vt.us/reports/tax/vol1-03.htm.

[30] This mirrors national and international trends: "As tax scholars have long observed, global tax competition has created a world in which states have gradually shifted the burden of taxation toward wages and consumption and away from capital and its owners, and in which tax revenues are increasingly falling behind the rising demands of the welfare state." Allison Christians, *Fair Taxation As a Basic Human Right*, University of Wisconsin Law School Legal Studies Research Paper Series, Paper No. 1066, p.2.

[31] Legislative Joint Fiscal Office, Vermont Tax Study: Volume 1 Comparative Analysis (2007), available at http://www.leg.state.vt.us/jfo/reports/2007-01%20Vermont%20Tax%20Study%20-%20Volume%201.pdf, p. 56; see also p. 58 (noting the passage of legislation allowing the creation of limited liability corporations and partnership in Vermont since 1996); [hereinafter "Vermont 2007 Tax Study"].

[32] The tax-rate on deposits for financial institution in Vermont is 0.0096%. State taxation of banks and financial institutions varies widely. Some impose a corporate income tax, some a franchise tax and a few others use share taxes. At least 5 states use some combination of these taxes (Vermont 2007 Tax Study, supra note 14, at 63). As the technology and nature of banking has rapidly changed, it is particularly difficult to determine the "best" strategy for bank taxation. See State Taxation of Banks: Issues and Options, Advisory Commission on Intergovernmental Relations (1989), available at http://www.library.unt.edu/gpo/acir/Reports/information/M-168.pdf.

[33] The highest tax rate on captive insurance premiums is 0.4%, for all other insurance company premiums it is 2%. Captive insurance companies, i.e. insurance companies that are subsidiaries set up by corporations to self-insure other members of the affiliate group, are given preferential treatment in the Vermont tax code. *See* Michael Kranish, "For Dean, 'Captive' Insurance a Vermont Boon," Boston Globe, December 12, 2003, at A1, available at

As a result, only 38% of businesses in Vermont are c-corporations subject to corporate income tax.[34] Of those, 76% only pay the minimum tax of $250. Of those, 55% are multistate or multinational corporations.[35] Beyond the minimum rate, the rate-bracket structure is relatively flat, and has been leveled further by recent rate reductions. It starts with a rather high rate (6%) at the very bottom end and does not rise much for more substantial incomes (8.5%).

Vermont's Legislative Joint Fiscal Office has acknowledged the difficulty of securing corporate contributions to state revenue::

> *A number of factors affect the stability of state corporate income tax revenue, including tax law changes, tax credits, tax avoidance and the impact of economic cycles. [...] At the state level, legal loopholes that are the result of state-level tax systems and an increasing number of state tax credits have also contributed to corporate tax revenue loss. [...] All of this has led to a serious erosion of the corporate income tax base and to less dependence on corporate income tax revenue in Vermont's overall state tax system.*[36]

Clearly, the majority of corporations in Vermont, including multinationals, are able to find loopholes in the system and avoid any reasonable corporate income tax payments. This appears to be a particular concern with regard to multistate and multinational corporations. Looking at corporate income tax returns received in 2003, the Vermont Department of Taxes reported that of the corporations with over $10,000 in taxable income, only two in-state corporations claimed the minimum tax, compared to 1,259 multistate or multinational corporations.[37]

Vermont tax law changes have indeed reduced corporate income tax receipts over recent years. In 2006-2007, corporate tax rates dropped from a range of 7-9.75% to 6-8.5%, and changes were made to the apportionment formula.[38] Apparently these measures were taken in an effort

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http://www.boston.com/news/politics/president/dean/articles/2003/12/12/for_dean_captive_insurance_a_vt_boon/?page=full (quoting a University of Connecticut tax specialist who explains that the company that sets up a captive insurance company in Vermont gets "deductions on the premium, they pay a low rate on the premium in Vermont, and then they take their premiums and they invest them and there is no further tax on them in Vermont or any other state"). All 50 states impose premium taxes on insurance companies.

[34] Vermont 2007 Tax Study, supra note 31, at 3.

[35] Multistate or multinational corporations account for 54% of Vermont's c-corporations. Id. at 56.

[36] Id. at 58.

[37] Id. at 62.

[38] The apportionment formula for businesses that operate in more than one state no longer gives equal weight to the 3 factors considered in corporate taxation: property, payroll and sales. Beginning in 2006, the sales factor is "double-weighted," so taxes are based on 50% sales, 25% property and 25% payroll. The intention here was to favor businesses that keep property and hire employees in-state, though there is no evidence that this is an influential consideration for businesses. See Mark J. Cowan, Clint Kakstys, Green Mountain Miracle, A Green Mountain Miracle and the Garden State Grab: Lessons from Vermont and New Jersey on State Corporate Tax Reform, in: Tax Law & Policy eJournal 08/2007, at 371,

to mitigate the impact of so-called unitary combined reporting (designed to capture income derived in Vermont but diverted to tax shelters in other states) on major multinational employers, including IBM and General Electric.[39] Yet substantial evidence shows that cutting corporate income taxes has neither a real impact on corporate bottom lines, nor a positive effect on economic growth or job creation.[40]

Unitary combined reporting does not require corporations to report income diverted to international tax shelters. At a minimum, Vermont could follow the example of other U.S. states and ask for this information as optional. Although there is insufficient data about how much revenue is lost today to tax avoidance in Vermont, in 2001, a Multistate Tax Commission estimated that Vermont was losing $7 to $14 million to U.S.-based tax shelters and another $8 million to tax shelters beyond U.S. borders.[41]

Vermont is lagging behind many other states in using corporate income tax as a source of state revenue. Vermont's corporate income tax represents 6.3% of total state and local business taxes, compared to 8.6% nationwide.[42] The impact of the 2006-2007 changes has not yet been studied by the state. However, it appears that rate reductions and significant loopholes in the corporate income tax structure allow for continued tax avoidance by multinational corporations in particular, and that greater equity could be achieved through more progressive tax rates, a review of tax credits and other reforms.[43] Prior to a full-fledged reform of the corporate tax code, corporate income tax alone does not appear to be an equitable, stable and sufficient vehicle for ensuring that businesses contribute adequately to healthcare financing.

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http://www.researchgate.net/publication/228152816_A_Green_Mountain_Miracle_and_the_Garden_State_Grab_Lessons_from_Vermont_and_New_Jersey_on_State_Corporate_Tax_Reform. Several states use a single-factor formula that only taxes the sales factor, not payroll or property, including Ohio, which uses a triple-weighted sales formula. See a comprehensive chart of the different formulas used by states throughout the United States, http://www.taxadmin.org/fta/rate/apport.pdf.

[39] Green Mountain Miracle, supra note 38, at 396 (note 375), 408, also Appendix W, 2. Vermont specifically excludes from combined reporting captive insurance companies in Vermont, 32 V.S.A. § 5811(22), leaving the favorable treatment of captive insurance companies undisturbed. See supra note 30.

[40] Center for Budget and Policy Priorities, *Cutting State Corporate Income Taxes Is Unlikely to Create Many Jobs* (September 2010), http://www.cbpp.org/cms/index.cfm?fa=view&id=3290

[41] Multistate Tax Commission, Corporate Tax Sheltering and the Impact on State Corporate Income Tax Revenue Collections (2003), http://www.mtc.gov/uploadedFiles/Multistate_Tax_Commission/Resources/Studies_and_Reports/Corporate_Tax_Sheltering/Tax%20Shelter%20Report.pdf

[42] Cutting State Corporate Income Taxes, supra note 40.

[43] See http://www.taxadmin.org/fta/rate/apport.pdf for the variety of apportionment formulas used across states, and tax-rates http://taxfoundation.org/article/state-corporate-income-tax-rates-2000-2012.

A role for payroll taxes?

The practical challenges of using a corporate income tax to generate equitable and sufficient healthcare contributions from corporations suggest that other options need to be considered.[44] Until the current corporate income tax structure can be reformed to eliminate loopholes and introduce equitable tax payments based on business size and profitability, companies will have to contribute in additional ways.

For many decades, payroll taxes have been used widely to ensure that businesses, not just individuals, contribute to various forms of social insurance, such as Social Security, Medicare, unemployment and disability insurance.[45] While healthcare premiums are also processed through the payroll mechanism, they consist of a fixed payment rather than a percentage of payroll or earnings. This means that premium payments are in no way tied to an employee's or company's ability to pay; on the contrary, low wage earners pay proportionally more of their earnings in premiums than high wage earners. Lower earners are also disadvantaged by the federal tax exemption for employer sponsored health insurance, which primarily benefits those with high incomes. Hence, the Hsiao report concludes that "[i]n terms of equity, a payroll contribution [based on wages] is far superior to the current health insurance premiums."[46]

Payroll taxes are less equitable

However, as Hsiao also acknowledges, payroll taxes are a significantly less equitable way to finance healthcare (or any other social insurance plan) than income taxes. While a payroll tax is a direct tax, it is usually flat with a contribution cap for high earners. In fact, this is exactly what Hsiao proposes in his financing recommendations.[47] It means that those with higher incomes would pay proportionally less money toward healthcare than those with lower incomes.

Moreover, payroll tax does not apply to incomes resulting from sources other than employment. Yet those so-called unearned incomes make up a greater share of wealthy people's income. Individuals with sizable incomes from dividends, stock transactions or other sources would effectively pay a much lower payroll tax rate, or no taxes at all, than those whose incomes are derived from wage labor. Payroll taxes on workers would place a disproportionate burden on people who work, compared to those who don't.

The generally regressive nature of payroll tax financing is confirmed by experiences in other countries. For example, in European countries with healthcare payroll taxes, such as Germany

[44] See also An Equitable Way to Pay for Universal Coverage, supra note 13, at 184-185.

[45] Single payer feasibility studies for Vermont tended to assume a payroll tax as the default financing mechanism; see Kenneth Thorpe, Costs and Implications of a Single Payer Healthcare Model for the State of Vermont, Vermont Commission on Health Care Reform, August 2006; and The Lewin Group, Analysis of the Costs and Impact of Universal Health Care Coverage Under a Single Payer Model for the State of Vermont, Office of Vermont Health Access, August 2001.

[46] Hsiao Report, supra note 15, at 94.

[47] Id.

and the Netherlands, research evidence shows healthcare financing to be "slightly regressive," contributing to increasing inequity in those societies.

Toward a progressive payroll tax?

However, since payroll taxes — under Vermont's current tax code — appear to be a more practical and effective way of eliciting business contributions to healthcare, it is worth exploring strategies for mitigating their regressive effect or even designing a progressive payroll tax structure. Some precedents exist. Healthcare payroll taxes in France, for example, include unearned income, which keep their effect on equity neutral. [48] Even among the various U.S. social insurance taxes, some are more regressive than others. For example, unlike Social Security, the Medicare tax is not capped for high earners; on the contrary, the Affordable Care Act requires employees earning over $200,000 per year to pay an additional 0.9%, increasing their Medicare tax rate to 2.35%.

We propose the following strategies for ensuring that a payroll tax on businesses meets the principle of equity:

- Levy a payroll tax only on employers, not on workers. Under our proposal, workers already contribute in an equitable and sustainable way through income taxes. The only purpose of a payroll tax should be to capture business payments that currently cannot be secured through corporate income taxes. A precedent for employer-only taxes already exists: unemployment insurance payroll taxes are levied on employers only.
- Small businesses should have a lesser tax burden than large corporations. This means the payroll tax must be graduated, not flat, and with exemptions at the bottom end. We propose a sliding scale rate, starting at zero, that increases with company size. With total payroll costs serving as a stand-in for size, the first $50k or $100k of payroll could be exempted from taxes, to be gradually phased in thereafter. Currently, small firms (fewer than 100 employees) that offer insurance pay about 5% of their payrolls toward health insurance, while large employers (with 100 or more employees) pay nearly 20%, which is in line with the principle of equity.[49]
- A graduated payroll tax on businesses should additionally be calculated based on a formula combining the number of employees and the distribution of wages. Such a formula could be used, for example, to penalize employers who pay extremely low wages or who have extreme wage disparity.

Payroll taxes keep healthcare dependent on employment

None of the above strategies can address the main drawback of payroll tax financing: the continued dependence of healthcare financing on employment. Any payroll tax is applied to the size of payroll which correlates with the number of employees, regardless of business profitability. Thus it effectively imposes a tax on hiring and employment. Moreover, it can also

[48] See Equity in the Finance of Health Care, supra note 11.

[49] John Franco, "And now, for the payment plan …", in: Rutland Herald, May 13, 2012.

lead to a depression of wages; first, by keeping the payroll small and thus reducing tax payments, and second, by indirectly shifting the burden of employer payroll tax costs to workers in the form of lower wages. This has been the effect of the current employer-sponsored insurance model of healthcare financing.

Our proposal of income tax financing, on the other hand, would enable Vermont to decouple healthcare from employment. If the corporate income tax code could be designed as an equitable and effective vehicle for secure business contributions to the healthcare system, such taxes would have no negative effect on hiring and wages, unlike premium or payroll taxes. The level of business contributions would then depend on a company's ability to pay rather than on the number and wages of their employees. If needed, additional tax credits could be made available to assist small businesses and sole proprietors.

Achieving equity through a mix of taxes?

Many countries rely on a mix of financing sources for their healthcare systems, yet evidence shows that a number of ancillary revenue sources reduce the overall equity of the financing scheme. For example, even in countries such as Canada that use only a small portion of indirect taxes (e.g. sales or consumption taxes) among their healthcare financing structure, the addition of such funding sources has benefited wealthier people and increased inequity.[50] This is because sales taxes are highly regressive, with low-income people paying proportionally significantly higher sales taxes than wealthy individuals. Where countries include some form of out-of-pocket payments, co-insurance or other types of user fees in their financing mix, evidence shows an even greater increase of inequity.

The Healthcare Is a Human Right Campaign envisions, instead, a mix of public financing strategies that best meet the principles of equity, as well as sufficiency and stability. This mix is centered around income taxes, including on unearned income, capital gains and wealth, as well as corporate income taxes targeted at larger businesses. To make up for the loopholes in the business tax structure, this mix should include, at least temporarily, a graduated payroll tax levied solely on employers.

5. Conclusion

To implement the principle of equity in healthcare financing, as required by Act 48, and to ensure sufficient and stable funding for Green Mountain Care, the Healthcare Is a Human Right Campaign proposes the following measures:

- Public financing through taxes
- No user fees or out-of-pocket costs (i.e. no cost-sharing)
- Income taxes on individual income, earned and unearned

[50] See Equity in the Finance of Health Care, supra note 11.

- Equalize taxes on capital gains with earned income tax rate
- A new wealth tax
- Some corporate income taxes, with a focus on reforming the corporate income tax code
- A progressive payroll tax only on employers, graduated with exemption at the bottom end

These measures, taken together, will guarantee that healthcare is financed in the most equitable way possible and ensure a sufficient and stable revenue base. We call upon the Administration and Legislature to give these proposals their serious consideration. We remind our elected officials that the principle of public participation in the design of our healthcare system is a key element of Act 48, Vermont's law for a universal healthcare system. The Healthcare Is a Human Right Campaign is composed of thousands of individuals with a right to have their voices heard.

Healthcare financing is intricately linked to tax reform in Vermont. We propose that as the state develops its healthcare financing plan, it also embarks on a reform of the tax code more generally, based on the principle of equity. This should include the measures outlined in this proposal, such as a reform of corporate income taxes, a review of business tax credits, a removal of capital gains tax breaks, and an introduction of a wealth tax. It should also take into account the environmental costs of economic development and put a price on activities such as pollution and resource extraction.

The state's tax code must ensure that it advances equity among the people of Vermont even - and especially - when federal taxation is designed to do the opposite. Moreover, revenue policy must follow budget needs, rather than trigger budget shortfalls. This shift in approach is essential in order for the state to fulfill the new legal requirements (32 V.S.A. § 306a) for meeting the fundamental needs of Vermont residents. Any and all reforms of the Vermont tax code, including those related to healthcare financing, must meet the basic principle of equity, as required by Act 48 and Vermont statute.