THE AUSTRALIA INSTITUTE

Health insurance tax rort

November 2002

This report concludes that private health insurance funds are facilitating and, in some cases, encouraging tax avoidance by providing products designed to assist high-income earners who have no desire to take out health insurance but who want to avoid paying the Medicare Levy Surcharge. These 'Clayton's' health insurance policies – the health insurance you get when you don't want health insurance – are unlikely to result in any significant shift in health costs from the public system to the private system but do represent a large drain on public revenue.

Background

Apart from exemptions for low-income earners and 'prescribed persons', all Australian taxpayers must pay the Medicare Levy of 1.5% of their taxable income. [1] High-income earners are required to pay a Medicare Levy Surcharge of 1% of their taxable income. However, these high-income earners are exempted from the Surcharge if they have eligible private health insurance with a registered health fund.

High-income earners are defined as single tax payers with taxable incomes in excess of $50,000 and couples or families with taxable incomes in excess of $100,000. The Surcharge thus adds $500 to the tax bill of singles with taxable incomes of $50,000 and $1,000 to the tax bill of couples and families with taxable incomes of $100,000.

The Government has said that the aim of the Medicare Levy Surcharge is to 'encourage high-income earners to take out private hospital cover and, where possible, to use the private system to reduce the demand on the public system'.[2]

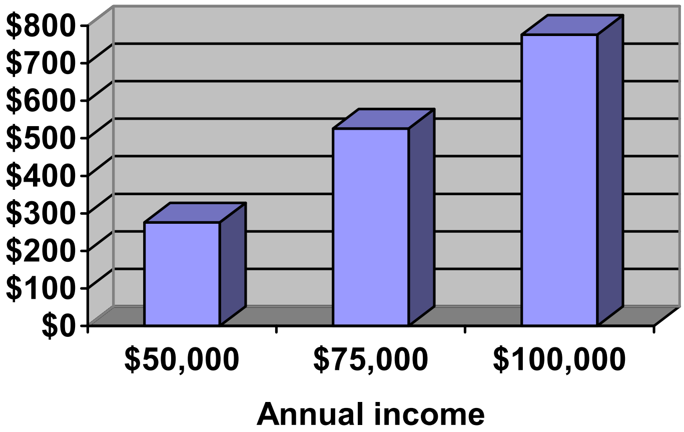
Any single person who does not want private health insurance but has a taxable income of $50,000 or more will be better off if they can purchase an eligible private health insurance product for less than $500 per annum because their tax savings will exceed $500. This is illustrated in Figure 1. A similar situation applies to couples and families. Indeed, there is extensive anecdotal evidence that tax accountants are urging their high-income clients to take out low-priced health insurance even if they have no desire to be insured. This assertion is backed up by the evidence collected for this report and presented below.

[1] See www.ato.gov.au for a list of all exemptions
[2] 'Medicare Levy Surcharge', Department of Health and Aged Care – www.health.gov.au/privatehealth/consumers/medlevy.htm

Following initial rorting of the system, the Government has stipulated that to qualify for exemption from the Medicare Levy Surcharge the health insurance purchased must have an excess (known as ‘front-end deductible’) of no more than $500 for singles or $1,000 for couples and families.

This rule was introduced in May 2000 in response to information that large numbers of high-income taxpayers were buying very cheap insurance products with very large excesses specifically designed to allow people to escape the Medicare Levy Surcharge. However, the changes have failed to prevent extensive tax avoidance by high-income individuals and do little to ‘reduce the demand on the public system’.

Figure 1 Potential annual tax savings for high-income singles from cheap health insurance



The products

It is useful to distinguish between the two types of private health insurance product that are marketed to high-income earners who are motivated primarily by the need to meet the conditions for exemption from the Medicare Levy Surcharge.

Low-cost public hospital cover

Public hospital cover provides insurance for treatment and accommodation in public hospitals but not in private hospitals. It also includes ambulance cover. These policies are cheap and are most likely to qualify as Clayton’s health insurance. By choosing a product with an excess, the cost of the premium can be reduced even further.

On entering a public hospital, a patient identifying as privately insured will be required to pay any excess under their policy, an amount up to $500. If the same patient does not identify as being privately insured they face no such charge. Apart from the tax saving, the only potential benefit to the consumers from holding such an insurance policy is the capacity to choose their own doctor and ambulance cover.

As detailed in Tables 1 and 2, some products covering only public hospital expenses are priced in the $200-$300 range, well below the $500 Medicare Levy Surcharge payable on an income of $50,000.

Low-cost private hospital cover with high excess

The second type of health insurance products that are being used to avoid the Medicare Levy Surcharge are those that, while providing some private hospital cover, rely on the large excess component to deter people from actually making claims on their private insurance.

In line with the Government's stated objective, any loss in tax revenue associated with gaining exemption from the Medicare Levy Surcharge should be offset by reduced expenditure on public hospitals associated with the shift towards reliance on private health insurance and greater use of private hospitals. However, several analyses have found that large numbers of people with private health insurance are not declaring themselves as privately insured when they enter public hospitals. The excess that cheaper private health policies often include is considered to be a major reason for this.

Last year, the Senate Community Affairs References Committee stated that: 'Of the 403,707 matched separations which took place in (NSW) public hospitals 39 per cent used their private health insurance status. The remaining 61 per cent did not declare their private health insurance status and were admitted as public patients'.[3] More recently Sullivan, Redpath and O'Donnell concluded that: 'This study has shed some light on another unintended result of the PHI reforms: the apparently increasing trend for some insured patients to behave, at least in their admissions to public hospitals, as if they are uninsured, thus further reducing one important source of income for public hospitals.'[4]

Policies currently available

A standard private health insurance package costs $700-$800 for a single person and $1400-$2000 for a couple or family. Table 1 lists the costs of insuring for public hospital cover in NSW for a range of health funds, while Table 2 shows some of the lowest-priced insurance products covering public and private hospital visits.

In the case of public hospital only insurance (Table 1), NIB offers public hospital insurance for only $275.65 per annum. Four funds provide cover for public and private hospital expenses for less than $400 (Table 2).

[3] Senate Community Affairs References Committee (2001) Healing Our Hospitals: A Report On Public Hospital Funding, p. 72

[4] Sullivan, N. Redpath, R. and O'Donnel, A. (2002) 'Who's looking after you? The difficulties in encouraging patients to use their private health insurance in public hospitals', *Australian Health Review*, Vol. 25 No. 3 pp. 6-14

Table 1 Low-priced health insurance products – public hospital cover only

Fund	Product name	Annual cost[a]	Excess
NIB	Public Hospital Cover	$275.65	$400
AXA	Start and Save Hospital Cover	$404	$500
Australian Unity Health	Smart Start	$443.80	$100[b]

a. After the 30% rebate. This is the cost for persons under 30. The price rises by 2% for every year over 30.
b. Includes day procedures in private hospitals

Table 2 Low-priced health insurance products – public and private hospital cover

Fund	Product name	Annual cost[a]	Excess
HCF	Hospital Advanced Saving Option	$223.85	$100/night in hospital for up to 8 nights[b]
Medibank Private	First Choice Saver Hospital	$304	$250
Health Insurance Fund of WA	Health Max Saver Plus	$375.75	$350
Federation Health	Hospital Excess 2	$427.20	$500
Grand United Health Fund	Price Point Hospital	$447.60	$250
Credicare Health Fund	S-75	$451.92	75% hospital cover and part coverage of doctors' fees
GMHBA	W3 Hospital Cover	$466.80	$500
MBF	Select Hospital Cover	$479.55	$500
NRMA Health	Hospital Value	$532.60	$500
Australian Health Management Group	Hospital Cover level 5	$582.40	$500

a. After the 30% rebate. This is the cost for persons under 30. The price rises by 2% for every year over 30.
b. The HCF product has been double-checked as the excess could exceed $500, in which case it would fail to meet government eligibility requirements for exemption from the Medicare Levy Surcharge.

Most funds have a product priced at around $500 dollars, although several offer cheaper policies. In the latter cases, taking out health insurance is effectively free for single people with taxable incomes of $50,000 or more, as they save at least $500 in tax. Singles earning over $50,000 are $100 a year better off for every additional $10,000 of income. The savings that can be made by high-income earners who purchase the lowest priced cover on the market are shown in Figure 1.

Extent of the problem

Our research shows that some health funds are fully aware of the fact that there is a demand for health insurance products aimed solely at tax avoidance and market their products accordingly. Most health funds have basic products priced at less than $500 to cater for those who do not want health insurance but do want to avoid paying the Medicare Levy Surcharge. Insurance products that cover public hospital admissions only have little other purpose.

In the course of gathering information for this paper, call centre operators at various funds were asked the following question: " Hi, I was speaking to my accountant and he said I could save a lot of tax if I got myself a cheap health insurance policy. I don't really need health insurance, I just want the cheapest policy that will allow me to avoid the Medicare Levy Surcharge. Have you got something that would suit me?" They were also asked whether they had many calls from people wanting to avoid the Surcharge.

The following comments were recorded.

- "We have a policy just for that."
- "We have had a *lot* of inquiries for tax purposes."
- "We do indeed; it's going to suit you down to the ground."
- "It's mostly young people taking this product. They aren't interested in insurance now, but they want to get in now so they don't have to pay a higher price later on."
- "You'd be surprised just how many people take this out. You can change your policy as your life changes."
- "Do you need it just for tax purposes?"
- "I think we have something that will do you fine."
- "You don't need to hear the exclusions do you? Because you're only interested for tax purposes."

Revenue losses

How much tax is being avoided by this device? To answer the question we need to know the number of high-income earners who have bought health insurance solely for the purpose of avoiding the Medicare Levy Surcharge and the amount of tax each one avoided (that is, 1% of their taxable incomes).

Unpublished data from the ABS allows us to make an accurate estimate of the lower bound of the taxation revenue lost through Clayton's insurance policies taken out by high-income earners. In a survey published in October 2002, the ABS asked a sample representing the 7,660,000 people with private health insurance why they had bought health insurance. Of the respondents, 9.6 per cent answered: 'To gain government benefits/Avoid extra Medicare levy'.[5] Some gave more than one answer, but 4.7 per cent gave this answer only. The numbers of high-income earners who gave this response only are shown in Table 3.[6]

An estimated total of 215,855 high-income households said that they took out health insurance solely for the purpose of avoiding the Medicare Levy Surcharge or gaining government benefits.[7] However, couple and family households with gross incomes between $50,000 and $100,000 are not liable for the Surcharge. To arrive at a conservative estimate we have calculated the amount of tax avoided by counting only singles with incomes in this range. The second column of Table 3 shows the proportion of households in the first three income brackets that are singles rather than couples or families for the purpose of calculating the extent of tax avoidance.

The amount of tax avoided by the use of Clayton's health insurance policies is conservatively estimated at $99 million per annum.

We have excluded from our estimate those who gave more than one reason for taking out private health insurance but whose principal motivation was to avoid tax. While 215,855 high-income earners mentioned only tax avoidance as their reason in the ABS survey, 477,670 high-income earners gave at least one additional reason. If it is assumed that the desire to avoid tax was the trigger motivation for half of those people, making their policies Clayton's policies, then the estimated tax avoided rises to $180 million. This is probably closer to the true figure than the conservative estimate of $99 million.

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[5] ABS, National Health Survey, ABS Cat. 4364.0, October 25, 2002. Table 25, p. 62

[6] The data in Table 3 use gross income while the thresholds for payment of the Medicare Levy Surcharge apply to taxable income. We have allowed for this by converting weekly income to annual income by multiplying by 50 instead of 52, thereby allowing a difference of $2,000 for gross incomes of $50,000 and $4,000 for gross incomes of $100,000. The ATO reports that the average deduction for taxpayers with incomes over $50,000 is $2,405 – ATO, *Taxation Statistics 1999-2000*, (2002) Table 3.3 (from www.ato.gov.au.)

[7] There are no government benefits available to high-income earners from taking our private health insurance.

Table 3 Persons who have health insurance solely to avoid the Medicare Levy Surcharge and the estimated tax avoided

Gross weekly income of household	Proportion of single house holds in group[a]	Persons with health insurance only for tax avoidance	Estimated tax avoided ($m)[b]
$1,000-1,199	0.18	39,291	$4.14
$1,200-1,499	0.12	60,608	$5.06
$1,500-1,999	0.11	55,719	$5.58
$2,000-2,499	1	31,127	$36.42
$2,500-2,999	1	17,512	$25.04
$3,000-3,499	1	5,821	$9.85
$3,500 or more	1	5,779	$12.77
Total		215,855	$98.84

a. Proportion only for first three income groups, and 1 thereafter as all households are required to pay the Surcharge if their income is $100,000 or more.
b. Calculated by multiplying the number in each income group by the proportion from the second column, and applying this number to the mid-point of the income range ($4,250 for the highest income group).
Source: Unpublished ABS data

Policy responses

The problem with the insurance products described above is that they are in some cases designed to encourage double dipping. Current arrangements allow people to avoid paying the Medicare Levy Surcharge by taking out private health insurance but do not require them to use their insurance to take pressure off the public hospital system.

At a minimum, the Government should move swiftly to remove policies offering only public hospital cover from eligibility for exemption from the Medicare Levy Surcharge. These policies do little more than increase the reported participation in private health insurance at substantial cost to the budget, with little reduction in the demand for public hospital services.

In addition, people with private health insurance should be required to use it when they enter public hospitals. After all, they have been exempted from paying their fair share towards the maintenance of the public health system. The Government should introduce a scheme whereby all public hospitals have access to a database of membership details and type of cover for all patients admitted to a public hospital. All patients with private health insurance for which they have received a taxpayer-funded subsidy would then be required to pay for their stay in hospital, the costs of which they have insured themselves against.

The implementation of such a policy would either induce people to purchase more expensive but more useable health insurance or discourage them from claiming the exemption from the Medicare Levy Surcharge. Both of these actions would deliver benefits to the health system overall.

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