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Is guv's **tax plan** legal?; Proposed payroll levy would violate federal law, experts say

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Gov. Rod Blagojevich's plan to tax **businesses'** payrolls to fund half his $2.1-billion health care reform would run afoul of federal law, legal experts say.

Under the plan, employers that spend less than 4% of their payrolls on worker medical benefits would be taxed, a spokeswoman for the **governor** says.

Lawyers say that approach could violate the 1974 Employee Retirement Income Security Act (ERISA). The federal law dictates how companies structure benefit plans so companies that do **business** in multiple states don't have to grapple with a patchwork of local laws. ERISA trumps any state law.

The **governor's** payroll tax ``definitely could be challenged, and I think successfully,'' says Linda K. Shore, a Washington, D.C.-based attorney at Mayer Brown Rowe & Maw LLP who specializes in ERISA law.

The payroll tax is crucial to Gov. Blagojevich's health care package, which aims to insure 500,000 of the state's 1.4 million uninsured adults by 2010. Employers that don't provide any insurance to workers would be hit with a tax equal to 3% of their payrolls. Companies that provide some insurance, but at an amount less than 4% of payroll, would pay some amount less than that 3% tax, based on a sliding scale. The **governor's** staff estimates the taxes will raise $1 billion a year. If a legal challenge were to shoot down the payroll tax, the balance would hinge on the other half of his proposal: a gross-receipts tax. **Business** leaders are girding for a fight on both.

Ms. Shore notes a U.S. court ruling last year that cited ERISA in striking down a 2006 Maryland law that would have forced companies with 10,000 workers or more to spend at least 8% of their payrolls on health insurance or pay that amount to the state (it only affected Wal-Mart Stores Inc.). A 2-1 appellate court ruling in January upheld the decision.

California Gov. Arnold Schwarzenegger's $12-billion health reform package includes a similar payroll tax. Some groups also have questioned whether his plan could violate ERISA.

Illinois officials say a payroll tax wouldn't violate federal law because the state wouldn't be dictating how employers should structure health benefits. The state simply wants companies to pay their share-even reimbursing a worker for out-of-pocket medical costs would count toward the 4% figure, says Bob Greenlee, deputy director of the Office of Management and Budget.

``We're on very firm ground,'' he says. ``The assessment allows **businesses** that would not otherwise contribute to health care to do so, but it doesn't force companies to switch around their benefit plans.''

But the Maryland appellate court concluded that giving employers the choice between meeting a minimum spending level or paying the state ``effectively requires employers . . . to restructure their employee health insurance plans'' and is ``precisely the regulatory Balkanization that Congress sought to avoid'' with ERISA.

Mark Johnson, a Texas attorney and an ERISA authority, says Gov. Blagojevich's proposal would draw a challenge. ``You're effectively mandating a certain level of spending, and that's a benefit-design issue," he says. ``That approach is pretty cut and dried that it will be pre-empted by ERISA."

The judges also cited the administrative headaches employers would face in proving to the state what they spend on health insurance. The **governor's** spokeswoman says employers would provide documentation in their state tax filings.

The legality of such proposals is cloudy because they are relatively new, as more states look to solve the uninsured problem, says Laura Tobler, a health policy analyst at the National Conference of State Legislatures.

``ERISA has been interpreted so broadly that it really ties the hands of state policymakers trying to craft a solution for covering the uninsured," she says.

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