The Daily Dish

May 28th Edition

DOUGLAS HOLTZ-EAKIN | MAY 28, 2015

A majority of Americans support the fast track TPA trade deal. The new Reuters/Ipsos poll shows only 13 percent of respondents opposed the legislation. Fast track would give negotiators more leeway in meetings, but still gives congress the right to a yes-or-no vote on each trade deal.

Congress is starting to ask how the IRS was hacked and over 100,000 tax payers' information was stolen. According to Senator Orrin Hatch, "When the federal government fails to protect private and confidential taxpayer information, Congress must act…Taxpayers deserve to know what happened at the IRS regarding the data theft."

ICYMI: Yesterday the administration finalized the controversial Waters of the United States rule. This will give the EPA more control over streams and tributaries. Those in rural areas worry that the EPA's expanded power will just cause headaches and more red tape. After reading the final rule, Senator Heidi Heitkamp agrees that the rule "unfortunately still considers many prairie potholes as waters that it will regulate, which doesn't address all of the serious concerns of farmers and ranchers."

Eakinomics: Obamacare's Cadillac Tax

The High Cost Plan Excise Tax, or "Cadillac Tax," is one of the key provisions of Obamacare, both from the perspective of raising revenue and health policy. Beginning in 2018, there will be a tax of 40 percent on the amount of employer-provided insurance that exceeds a threshold. The threshold is set at $10,200 for individuals and $27,500 for family coverage in 2018, but is adjusted upward each year based on the Consumer Product Index (CPI). The Cadillac tax has been politically contentious from the outset and is garnering increasing attention, in part because some employers are already exceeding the threshold and are contemplating life with the tax.

The Cadillac tax raises a number of questions:

1. Who will be affected? Nobody knows for sure. However, historically CPI inflation (which indexes the thresholds) has been lower than increases in health care spending. As a result, premiums are likely to rise more rapidly than the thresholds, pushing more and more plans into the Cadillac tax. This fact is reflected in the Congressional Budget Office projections of increasing revenue from the Cadillac tax, rising from roughly $10 billion in 2018 to in the vicinity of $25 billion in 2021.

2. Who will pay the tax? The Cadillac tax is advertised as a tax paid by the sellers of "high cost" plans. Yes, but the calculation of the tax ensures that all of the insurance received by an employee is used to calculate the tax. In the simplest case, an employee might receive a family policy worth $30,000, entirely paid by the employer. The value of the insurance exceeds the threshold by $2,500 and leads to a Cadillac tax of $1,000. The employer notifies the insurance company, which has to send in the check.

Another possibility is that the employer pays only $27,000 and shifts $3,000 of the premium to the employee.

The total contribution is still $30,000 and the tax is still $1,000. Once more, the insurance company is notified and sends in the check.

Alternatively, the policy could come with an Health Savings Account (HSA). The employer pays only $27,000 for the insurance but contributes $3,000 to the HSA. HSA contributions count as health insurance for purposes of the Cadillac tax, so the total is still $30,000 and the tax still $1,000. In this case, however, both the employer and the insurance company must send in checks. The employer pays 10 percent of the total and owes $250 in tax. the insurance company sends in the remaining $750.

3. Who will really pay the tax? Employees. Perhaps not instantly and perfectly, but quickly and relatively accurately, insurance companies will raise premiums to cover their tax. In the example used above, the presence of the Cadillac tax turns a $29,000 policy into a $30,000 policy to make sure the insurer is held harmless from the tax. That means the tax is imposed on the employer and employee. Over time, the overwhelming evidence is that eventually wages rise less than they otherwise would to accommodate the employers' insurance costs. In this way, employees end up footing the bill.

4. Is the Cadillac tax fair? Not by the usual measures of fairness. As noted above, workers end up paying tax on a portion of their health insurance at a 40 percent rate. Since nobody has an income tax rate of 40 percent, that means health insurance is taxed more highly (at the margin) than wage income. And since it is 40 percent for everyone, it means the middle class and poor are paying at the same rate as the affluent. For purposes of comparison, the other leading proposal to tax health insurance is to cap the value of health insurance that can be excluded from income tax. That means the amount over the cap (just like the Cadillac tax) is taxed at an individual's income tax rate — the same rate as wage income and tax rate computed in a progressive fashion.

5. How will employer sponsored insurance change because of the Cadillac tax? That is the $27,500 question. One possibility is employers will demand insurers provide cheaper policies or, equivalently, insurers will develop cheaper, competitive policies by finding lower cost networks of providers. If quality is unchanged or better, this is the desirable outcome of using a price incentive to "bend the cost curve." A fear, however, is that employers and insurers will instead simply cut some services out of insurance; in the worst case valuable and desirable services.

The Cadillac tax raises more questions than are answers, but it is a central feature of the Obamacare landscape.

From the Forum

New Medicaid Managed Care Rule: Sprawling Red Tape by Dan Goldbeck, AAF Research Analyst