AMERICAN ACTION FORUM

Primer: Cadillac Tax (High Cost Plan Excise Tax)

Emily Egan *June 25, 2013*

Introduction

The High Cost Plan Excise Tax, which is often referred to as the "Cadillac Tax" is one of the revenue raising provisions in the 2010 Patient Protection and Affordable Care Act. The excise tax is calculated by comparing the cost of an employer-sponsored plan (which includes premiums paid by the employer and/or employee as well as any contributions into health accounts such as health savings accounts of flex savings accounts) to a benchmark, which will be adjusted every year based on the Consumer Product Index (CPI). Any amount above the benchmark is taxed at 40 percent; this tax is levied on the health insurance company but is generally understood to be passed onto the consumer, or firm purchasing that plan.

Political History and Overview

The Cadillac Tax generated significant controversy during Congressional negotiations over health reform. As originally passed, the ACA set the effective date for the tax as 2013. When the law was amended a week later by the Health Care and Education Reconciliation Act the Cadillac Tax was delayed until 2018 with starting thresholds of $10,200 and $27,500 for single and family coverage, respectively. The benchmarks are adjusted upward by $1,650 for single coverage and $3,450 for family coverage if the employer is covering those in high risk professions. The premium threshold after which the tax is triggered is adjusted upward if the Blue Cross Blue Shield Standard Plan for Federal Employee Health

Key Takeaways

Overview of the Tax

- The High Cost Plan Excise Tax (Cadillac Tax) is a 40 percent tax levied on the dollar amount of employer sponsored insurance premiums exceeding a threshold for individual or family coverage, if premiums exceed that threshold.
- Premium amounts are calculated from the employer portion, the employee portion and any funds put into a savings account.
- The threshold is set at $10,200 for individuals and $27,500 for family coverage but is adjusted upward if premiums for the Blue Cross Blue Shield Standard plan offered to federal employees sees premium growth from 2010-2018 in excess of 55 percent.

Political History

- Two key reasons behind opposition of generous employer sponsored health benefits is the unequal tax benefit, and the theory that generous benefits promotes overutilization of health care.
- The original Senate version of the Affordable Care Act had the tax going into effect in 2013. When the bill was amended a week after passage, the tax was delayed until 2018.
- Both unions and large employers have opposed the tax, and union health plans were to be exempted until 2018 when the tax was originally meant to be levied for everyone else in 2013.

Current Projections

- The Congressional Budget Office has adjusted their revenue projections downward, as premium growth is slowing.

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Benefits sees premium growth between 2010 and 2018 in excess of 55 percent, based on the benefits offered in 2010.

There has long been opposition to extremely generous employer-sponsored insurance for several reasons. Because of the value of employer sponsored insurance is not taxed as income, those with higher salaries receive a larger effective tax break for receiving generous benefits, as their tax rate is higher. The employer would rather provide generous benefits than additional pay, as the health insurance benefits are tax deductible. In some sense the generous benefits result in reduced tax revenue as it is a form of untaxed compensation. The excise tax provides a disincentive for employers to provide overly generous health benefits without having to overhaul the tax treatment of health insurance, which would likely encounter major political opposition.

Secondly, there is a theory that more generous health care coverage leads to overutilization of services. As researchers seeking to estimate the effects of the Cadillac Tax write, "The anticipated shift to less generous insurance will lead to decreases in health care utilization (with the hope that these decreases in utilization will be for low-value medical care rather than high-value care)."[1]

Employer sponsored plans that are particularly generous often have large provider networks, a long list of covered services and low deductibles, and are, as a result, very expensive. Supporters of the tax believe it will make employers more invested in reducing employee health costs, and Jonathon Gruber an economist who helped shape the ACA was quoted in the New York Times as saying of the tax, "It's focusing employers on cost control, not slashing."[2]

Opponents of the Cadillac Tax point to the fact that there are other factors driving up premiums besides generous benefits. Having a disproportionately sicker or older workforce, or living in an area with highly priced medical services can lead to above-average healthcare costs without benefits that are especially generous. Other opposition has come from unions, which often negotiate very generous benefit packages.[3] Originally when the tax was written into the ACA to begin in 2013, the unions secured a special exemption from the tax until 2018[4]; the final version was amended to push the tax back for everyone until 2018.

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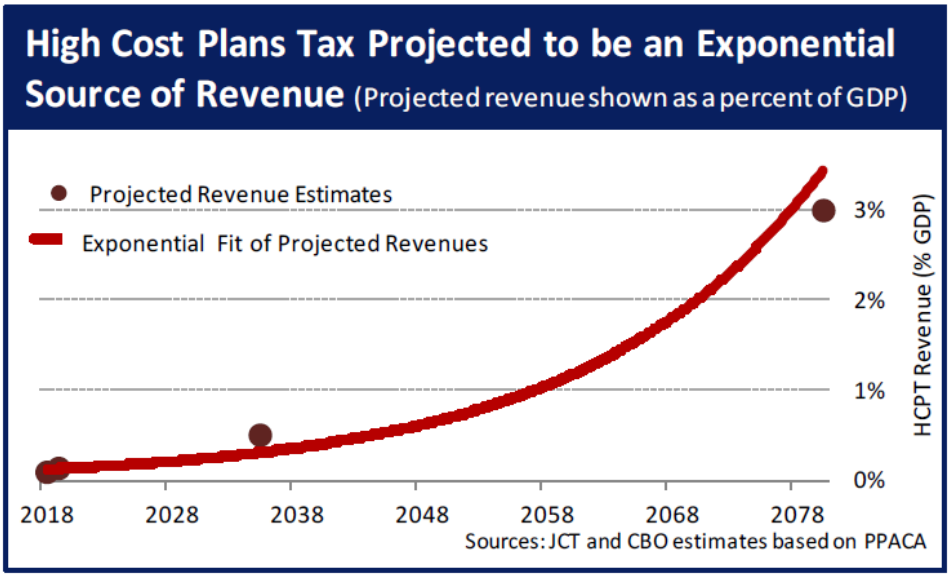
[1] Herring B, Lentz LK. "What Can We Expect from the 'Cadillac Tax' in 2018 and Beyond?" Inquiry. 2011-2012 Winter;48(4):322-37.
[2] Abelson, Reed. "High-End Health Plans Scale Back to Avoid 'Cadillac Tax" The New York Times. May 27, 2013. Available: http://www.nytimes.com/2013/05/28/business/cadillac-tax-health-insurance.html?pagewanted=1&hp
[3] Hemingway, Mark. "The Unions vs. Obamacare: Disenchantment sets in." The Weekly Standard. Mar 25, 2013. Available: http://www.weeklystandard.com/articles/unions-vs-obamacare_707688.html?page=1
[4] "Labor's $60 Billion Payoff." Wall Street Journal, Jan 16, 2010. Available: http://online.wsj.com/article/SB10001424052748703657604575004992410621692.html

Budget Estimates

For budgetary reasons, the Cadillac Tax is very important to the claim that the ACA will reduce the deficit. Because health care costs have generally risen faster than inflation the tax was scored as a significant source of revenue in the original Congressional Budget Office (CBO) projections, especially in the long term, and thus key to making the ACA reduce the deficit when scored. Figure 1 displays the CBO projections for tax revenue in 2035 and 2080 at .5 percent and 3 percent of GDP respectively.[5]

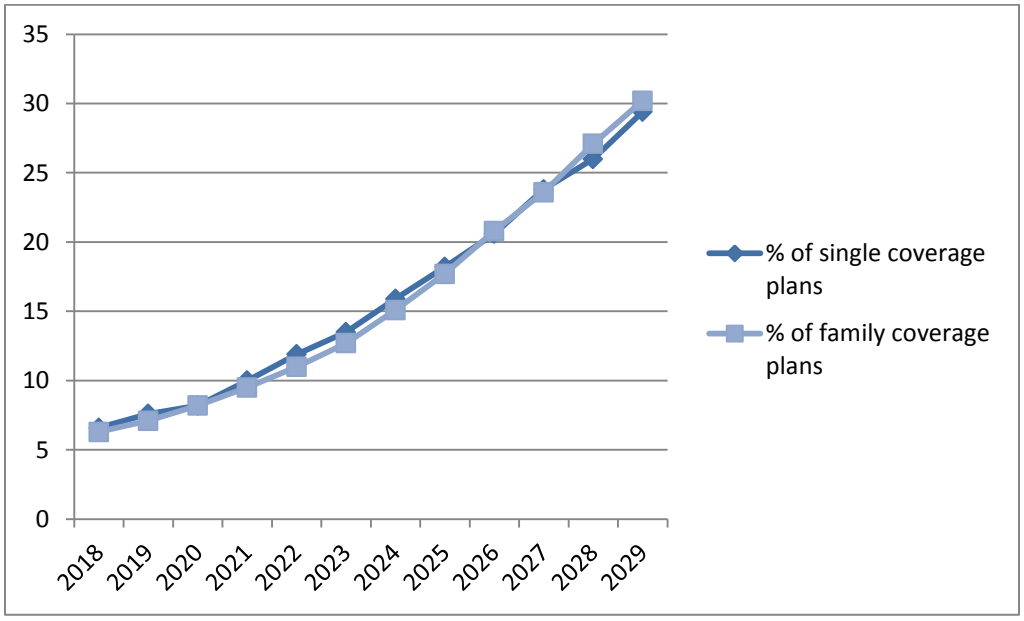
Figure 1: Cadillac Tax Revenue as a Percentage of GDP



Several reports have attempted to model the likelihood of plans reaching the Cadillac Tax threshold. Researchers published in the Journal *Inquiry* looked at the percentage of plans that would be taxed assuming different premium growth rates. While they looked at the scenarios under premium growth rates of 4.5 percent, 6 percent and 7.5 percent, 4.5 percent seems most likely given recent growth rates. At 4.5 percent annual premium growth, 6.6 percent of individual plans and 6.3 percent of family plans will be subject to the tax in 2018, and this rises to 29.4 percent for individual plans and 30.2 percent for family plans by 2029, assuming no action is taken to reduce benefits. Figure 2 below charts their projections from 2018-2029.

[5] "New Data Suggests Health Law's Cost Rising." Joint Economic Committee, Republicans. Oct 4, 2010. Available: http://www.jec.senate.gov/republicans/public/?a=Files.Serve&File_id=b18a76f8-7580-4d17-b4b5-fd92f48dcbd2

Figure 2: Projected Percentage of Plans Impacted by Excise Tax, 4.5% Annual Premium Growth Rate



Source: Herring & Lenz "What Can We Expect From the 'Cadillac Tax' in 2018 and Beyond?"

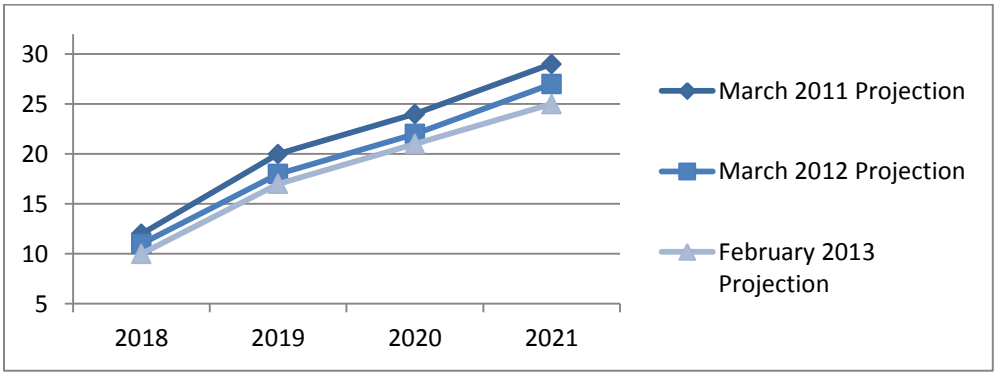
Republican staff on the Joint Economic Committee put out an analysis of the tax in 2010 predicting that revenue collected by the tax would be lower than expected, as a result of the threshold being adjusted upward. As mentioned above, if premiums for the Blue Cross Blue Shield Standard Federal Employee Health Benefit plan experienced premium growth over 55 percent from 2010-2018, the threshold would increase by the percentage of premium growth over 55 percent. This situation was seen by the committee as likely when historical growth rates were analyzed. According to their report "Between 2000 and 2011, premiums for the BCBS Standard plans rose annually by an average of 8.63%. If this trend continues, growth in the BCBS Standard plans would be 92% between 2010 and 2018—significantly more than the 55% benchmark set in PPACA. As a result, the HCPT thresholds would rise by 37%."[6]

Recent CBO projections have similarly seen less revenue from the tax, as shown in Figure 3, but for entirely different reasons. The recent slowdown in the growth rate of health spending, and thus premium costs, make it less likely for plans to reach the threshold amounts of $10,200 for individual coverage and $27,500 for family coverage. The CBO blog post published in May, 2013 notes that data on lower premium growth rates than

[6] "New Data Suggests Health Law's Cost Rising." Joint Economic Committee, Republicans. Oct 4, 2010. Available: http://www.jec.senate.gov/republicans/public/?a=Files.Serve&File_id=b18a76f8-7580-4d17-b4b5-fd92f48dcbd2

previously projected led them to adjust down their estimate of tax revue from the Cadillac Tax by $58 billion over 10 years, because they expect fewer plans to be subject to the tax.[7]

Figure 3: CBO Projections of Cadillac Tax Revenue, 2018-2019, in Billions



Sources: CBO Reports[8]

The National Business Coalition on Health reported the adjusted CBO estimates, commenting that potential reasons for the revised numbers include reduced health spending as a result of the recession, increased employee cost-sharing, greater investment in employee wellness programs, and more effort to negotiate lower reimbursements with hospitals and physicians.[9]

[7] "CBO's Estimate of the Net Budgetary Impact of the Affordable Care Act's Health Insurance Coverage Provisions Has Not Changed Much Over Time" Congressional Budget Office. May 14, 2013. Available: http://www.cbo.gov/publication/44176

[8] Elmendorf, Doug."CBO's Analysis of the Major Health Care Legislation Enacted in March 2010" Testimony for the Subcommittee on Health, Committee on Energy and Commerce, U.S. House of Representatives. Mar 30, 2011 Available: http://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/121xx/doc12119/03-30-healthcarelegislation.pdf

"Updated Estimates for the Insurance Coverage Provisions of the Affordable Care Act" Congressional Budget Office. Mar 2012. Available: http://www.cbo.gov/sites/default/files/cbofiles/attachments/03-13-Coverage%20Estimates.pdf

"CBO's February 2013 Estimate of the Effects of the Affordable Care Act on Health Insurance Coverage" Congressional Budget Office. Feb 2013. Available: http://www.cbo.gov/sites/default/files/cbofiles/attachments/43900_ACAInsuranceCoverageEffects.pdf

[9] "Projected Tax Revenues from "Cadillac Tax" Drop in New CBO Estimate". National Business Coalition on Health Newsletter. May 17, 2013 http://nbchnewsletter.blogspot.com/2013/05/projected-tax-revenues-from-cadillac.html

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Cadillac Tax Case Study

Table 1 below outlines the impact of the Cadillac Tax on a hypothetical company with 1,000 workers and premiums of $10,400 for individual coverage (500 employees) and $28,500 for family coverage (500 employees) in 2018. Both the individual and family coverage exceeds the threshold slightly, but enough to trigger the tax and add $225,000 in insurance costs, assuming the likely reality that the tax will be passed on entirely from the insurance company to the employer.

Table 1: Hypothetical Employer Tax Scenario, 2018

	Total Premium	Threshold	Taxable Amount	Tax Rate	Tax on Each Premium	Effective Premium (after tax is added)	# of workers	Bottom Line Impact
Individual	$10,400	$10,200	$200	40%	$50	$10,450	500	$25,000
Family	$28,500	$27,500	$1,000	40%	$400	$28,900	500	$200,000

Total: $225,000

Conclusion

The Cadillac Tax was a key component of the Affordable Care Act's CBO score, although it was controversial and opposed by employers and unions. The fact that the tax is triggered by a specific, but flexible, threshold and revenue from the tax is largely dependent on premiums cost-growth and employer behavior regarding benefit and cost-sharing levels makes it very hard to predict the impact of the tax, and as a result CBO projections have been adjusted year to year.