The Cadillac Tax: What You Need to Know

ISSUE BRIEF

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KEY TAKEAWAYS

Bipartisan legislation would repeal Cadillac Tax, allowing businesses to offer better, more affordable coverage.

Keeping the tax impacts most people with coverage at work, hitting the middle class the hardest.

The tax increases deductibles and other cost-sharing, making it more expensive to get medical care.

Will lead to an increase in the uninsured and cut benefits for those with coverage.

Executive Summary

Beginning in 2022, federal law imposes a new 40-percent excise tax on employer-provided health benefits. Within a matter of years, most of the 180 million Americans with coverage at work will see their health care costs go up as a result. The tax applies to premiums, Health Savings Account (HSA) and Flexible Spending Account (FSA) contributions, as well as wellness programs, on-site medical clinics, and other features of health plans. The effect of the looming tax has weakened health care quality. Companies are working to reduce the total cost of their benefits by increasing deductibles and other cost-sharing in an effort to avoid being taxed as long as possible.[1] Others have dropped spousal coverage or stopped offering valuable benefits like wellness programs and HSA contributions. Congress has already recognized how harmful this tax will be, voting twice on a bipartisan basis to delay the tax. It is urgent that Congress fully repeal this tax to help mitigate the burden of rising deductibles on millions of Americans who rely on health coverage through their employer.

Background

What is the Cadillac Tax?

The Affordable Care Act added Section 4980I to the Internal Revenue Code, instituting a 40 percent excise tax on employer-provided health coverage whose costs exceed a statutory dollar amount. The law called for the tax to take effect January 1, 2018, but has since been delayed twice. The tax is now scheduled to take effect January 1, 2022.[2]

Any coverage costs above the threshold (indexed in future years) will be taxed at a 40 percent rate, with the tax to be paid by the insurance provider or plan administrator. For planning purposes, the thresholds for high-cost plans are currently $10,800 for individual coverage, and $29,100 for family coverage. When assessing the tax, the cost of coverage includes contributions to premiums paid by both the employer and employee, as well as other costs, including the individual's received value for a wellness program, HSA and FSA contributions, and on-site medical clinics.[3] How that cost will be determined will be the subject of a future federal regulation.

The Issue

What the tax will do

This excise tax was introduced as a way to slow down the rising cost of care by disincentivizing what were termed overly generous plans. However, federal law does not consider the impact of rising costs for health care services. These services, which include doctor care, hospital visits, and prescription drugs, account for about 80 cents of every dollar spent on premiums. As health care costs rise, the value of coverage needed to pay for those services goes up – pushing more employers toward the excise tax threshold.

This, in turn, further raises the cost of health care coverage for hundreds of millions of

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180 million Americans

depend on employer-provided coverage for their health and financial protection

Americans, making it harder for them to get affordable, comprehensive coverage. The excise tax will hurt businesses and families of all income levels, and leave millions of Americans paying more money for less health coverage.

One common misunderstanding about the tax is that it only affects a small percentage of plans owned by high-income workers. However, when the tax takes effect in 2022, a full 74 percent of health plans will be affected by the tax.[4] A Towers Watson analysis revealed that within 5 years of the tax's taking effect, "82% [of employer plans] could cross the threshold."[5] Experts say that eventually all employer plans will be subject to the tax.[6] Those impacted will be mostly middle class families, with a 2016 study finding that "[t]he "Cadillac Tax" on health benefits in the United States will hit the middle class hardest." It found that the tax "will disproportionately harm families with (2009) incomes between $38,550 and $100,000."[7]

The impact of the tax recently became more widespread due to a recent change in how the tax will be determined. The 2017 Tax Cuts and Jobs Act included a provision that will result in more health plans being hit by the tax at a faster rate. As the cost thresholds for the tax are indexed for inflation, the new law requires the calculation to be based on the "chained Consumer Price Index" sometimes referred to as C-CPI-U.[8] This method means that inflation will be calculated well below medical inflation and health plans will be more likely to be subject to the excise tax, and they'll be taxed sooner than under the previous method.

In 26 states, the typical plan subject to the tax is equivalent to a silver plan on the exchange, in which the plan covers approximately 70 percent of medical costs – far from a "luxury" benefit offering.[9] Silver plans are mid-tier plans on the exchange and are the most popular plans among people who buy their own coverage.

The only ways that companies can avoid the tax is to either increase what consumers pay for their care, or decrease services provided. This means that employers will have to make tough choices about increasing cost sharing (deductibles, co-pays, co-insurance) or eliminating coverage benefits, such as mental health care and maternity care, or to stop offering coverage for spouses. The average employer impacted by the tax can be expected to shift $480 in cost-sharing to each employee annually.[10]

Health care costs drive the cost of health plans. Therefore, areas where health care costs are higher will be harder hit by the tax, as will certain groups with higher medical costs, including women. Businesses in the Northeast, as well as states like Alaska, California, Florida, and Texas, or in industries with higher claims or that employ more women will be more likely to be forced to pay the tax.[11] In other words, taxing health benefits won't make health costs go down, it will simply force employers to drop health benefits or shift more costs to workers.

The tax is already causing real impacts

The actuarial and benefits consulting firm Aon Hewitt reported in 2015 that 33 percent of employers surveyed are increasing deductibles and other cost-sharing, to avoid being on a trajectory to trigger the tax when it goes into effect. Employers are shifting to high-deductible health plans – including many as their only plan offering. These plans make sense for some consumers, but not all. Regardless of plan type, deductibles continue to rise as employers take efforts to avoid hitting the tax, if at all possible.[12] They're also cutting back on wellness programs and investments like on-site clinics, or reducing HSA contributions – all of which count towards the excise tax.

For patients, this tax isn't just about money. As employers plan now for eventual implementation of the tax, it impacts their treatment, access to care, and overall health. Because the tax increases deductibles and other forms of cost sharing, it makes going to the doctor or getting a prescription filled more expensive. For many families, this means foregoing treatment or not filling a prescription, having serious consequences for their health.

What the tax does to other markets and the health system

Despite what some have claimed, the excise tax won't help drive down the cost of health care. The reason is simple: It does nothing to drive down underlying health care costs. For example, it does not bring down high drug prices, or eliminate unnecessary or wasteful care. Strategies to address these costs are led separately by employers and health insurance providers together, through tools such as negotiating lower drug prices or medical management practices that encourage safe care. In fact, nearly every employer offering coverage works aggressively to be efficient in their offerings so they can continue to offer more affordable coverage.

When health benefits are taxed, it's not just employers and workers who are impacted; the entire health care system will be negatively affected. The tax will shift more people to the exchanges, increasing federal spending. It discourages programs like wellness programs, telemedicine, and on-site clinics that help improve health – pushing costs of future care higher. It will keep millions from going to the doctor. It hurts American businesses of all sizes. It will increase the number of Americans without insurance.

Congress should take action now to ensure that every American can get affordable, comprehensive coverage that protects their health and financial security. Congress should repeal the Cadillac Tax as a harmful excise tax that threatens Americans and their health.

Endnotes

[1] https://www.forbes.com/sites/brucejapsen/2015/08/12/as-obamacares-cadillac-tax-looms-employers-raise-deductibles-shift-costs/#7fe0a0e8aac5
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[3] https://www.kff.org/health-reform/issue-brief/how-many-employers-could-be-affected-by-the-cadillac-plan-tax/
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[7] Woolhandler, S., & Himmelstein, D. U. (2016). The "Cadillac Tax" on Health Benefits in the United States Will Hit the Middle Class Hardest. International Journal of Health Services, 46(2), 325-330.
[8] Public Law 115-97, Section 11002. (December 22, 2017) Text available at https://www.congress.gov/115/plaws/publ97/PLAW-115publ97.pdf
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[11] http://beta.nea.org/assets/docs/Milliman--What_Does_the_Excise_Tax_Actually_Tax.pdf
[12] See endnote (i), *supra*.