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The Excise Tax on High-Cost Employer-Sponsored Health Insurance: Estimated Economic and Market Effects

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Summary

The Patient Protection and Affordable Care Act (ACA; P.L. 111-148, as amended) included a provision to impose an excise tax on high-cost employer-sponsored insurance (ESI) coverage beginning in 2018. This provision, popularly termed the *Cadillac tax*, imposes an excise tax on ESI coverage in excess of a predetermined threshold. The tax is imposed on the coverage provider, typically the health insurance provider or the entity that administers the plan benefits.

Currently, employers' spending on ESI coverage and most employees' contributions to ESI plans are exempt from income and payroll taxes. Although proposals to limit the amount of health insurance benefits eligible for this exclusion were considered, the ACA, as enacted, did not limit the exclusion for employer-provided health insurance coverage. The Cadillac tax discourages high-cost employer health plans through another approach.

The Cadillac tax is imposed at a rate of 40%. This tax rate is applied on a *tax-exclusive basis*, as is generally the case with excise tax rates. That is, like a sales tax, the rate applies to the price or cost excluding the tax. By contrast, the tax rate relevant to an income tax exclusion is on a *tax-inclusive basis*: it is applied to a base that includes the tax. The Cadillac tax is nondeductible from the insurer's gross income (or the employer's gross income, in cases where the employer self-insures). This treatment is unlike other excise taxes.

The Cadillac tax takes effect in 2018 and is imposed on plans that cost more than $10,200 for single health plans and $27,500 for non-single (e.g., family) plans. The exempt amount is indexed for inflation, and, because health costs tend to grow faster than inflation, the share of premiums covered by the tax and the revenue collected is expected to grow.

This report examines several issues. It evaluates the potential of the Cadillac tax to affect health insurance coverage and the health care market. It also examines the expected incidence (burden) of the tax—that is, which group's income will be reduced by the tax. Finally, the report discusses implications for economic efficiency in the context of tax administration.

Estimates suggest that the Cadillac tax could lead to an overall decline in the quantity of health services as some firms reduce the size of their insurance coverage. This decline is estimated to range from 0.5% to 0.6% in 2018 and from 2.2% to 2.5% in 2024. Prices could fall by up to 0.4% in 2018 and up to 1.5% in 2024 (although costs paid by some consumers could rise due to cutbacks in Cadillac plans). Overall expenditure (the sum of the fall in quantity and the fall in price) could decline by 0.6%-0.9% in 2018 and by 2.5%-3.6% in 2024. In other words, the tax could result in a gross reduction of $7.6-$11.0 billion in national health expenditures in 2018 and $41.0-$60.3 billion by 2024.

Although the tax is imposed on insurers or employers, the burden is expected to fall on wages. In some cases, employers will retain the Cadillac insurance plans and pass the tax on to workers in the form of lower wages. In other cases, employers will substitute taxable wages for insurance coverage in excess of the threshold, and employees will be subject to income and payroll taxes on those wages. Revenue projections assume the latter situation will be more common.