2016 MAKING ISSUES COUNT

THE CADILLAC TAX AND CHANGING THE TAX TREATMENT OF EMPLOYER-SPONSORED COVERAGE

THE AFFORDABLE CARE ACT (ACA) provision that receives a lot of attention is the excise tax on high-cost employer sponsored plans, also referred to as the "Cadillac tax." This tax imposes a 40 percent excise tax on the premiums that exceed certain thresholds. The intention, in part, is to discourage enrollment in very generous health plans that can drive up health care spending and premiums. Congress recently delayed the implementation of the tax from 2018 to 2020. The 2018 thresholds would have been $10,200 for individual coverage and $27,500 for family coverage, but they will increase to reflect the new start date and will increase with inflation thereafter.

There have been some calls to modify the tax or to eliminate it altogether. One concern with the tax is that plans with high premiums are not necessarily overly generous. For instance, businesses with an older workforce, in certain industries, or in certain parts of the country could face higher premiums, irrespective of the generosity of the plan. Although the law allows the excise tax threshold to be increased for businesses with older populations or in high-risk professions, the thresholds do not vary to reflect geographic variations in health spending.

Alternatives to the Cadillac Tax

Some proposals to replace the Cadillac tax would change the tax treatment of employer-provided health coverage. Currently, employer premium contributions are tax-deductible as a business expense and excluded from employee income and payroll taxes. For many workers, savings due to the tax exclusion can be substantial. The tax exclusion is more valuable to higher earners, however, because they face higher marginal tax rates. Not incurring these taxes provides a strong incentive for employers to sponsor health insurance. In addition,

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many employees, including union workers, also receive generous health care benefits that have been negotiated into their contracts.

One suggested alternative would cap the amount of premium payments that can be excluded from income for tax purposes (i.e., tax exclusion cap); this would be another way to encourage enrollment in less-generous plans. Another proposal would eliminate the tax exclusion altogether and replace it with a tax deduction or a tax credit for people with health insurance, regardless of whether it was received through an employer or purchased in the individual market. Such tax deductions or credits could be structured to vary based on income.

The impact of such proposals on employers' decisions to offer coverage, workers' decisions to purchase coverage through their employers or elsewhere, the number of uninsured, and health spending growth would depend on how they are designed. Considerations include whether the tax breaks are in the form of a tax deduction (which tend to favor higher-income workers) or tax credits (which can increase the benefit to lower-income workers, especially if they are refundable), and whether they vary by income. The amount of the tax exclusion cap or deductions/credits, whether and how they increase over time (e.g., with inflation), whether they vary based on factors outside of the employer's and worker's control (e.g., geographic area, age), and how they compare to tax advantages for coverage outside of the employer group market would affect the relative attractiveness of employer-sponsored coverage.

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