Introduction to the Cadillac Tax

Purpose and Inception

The Affordable Care Act (ACA) established a 40% excise tax on high-costs health plans to help finance the expansion of health coverage associated with provisions of the law, including Medicaid expansion and health insurance exchange subsidies.\(^1\) The High Cost Employer-Sponsored Health Coverage Excise Tax, as the program is formally named, is scheduled to take effect in 2018 and applies to most employer-sponsored plans with annual premiums that exceed a threshold of $10,200 for individuals or $27,500 for families; this threshold will be adjusted to inflation on an annual basis. Costs exceeding the value of these premium amounts are considered “excess health spending” and are subjected to the tax.

The tax has been nicknamed the “Cadillac Tax” in reference to a luxury tax, as the program affects health packages deemed to be generous. The term “Cadillac plan” refers most commonly to plans with wider provider networks and relatively generous coverage of health services. Not all Cadillac plans offer robust coverage, as some high premiums are mainly due to the health status, age, and gender of the plans’ pool of members. Employer-provided health insurance coverage has traditionally realized a tax advantage, in that health benefits are considered part of employees’ compensation packages but are not taxed as wages. It has also been argued that benefit-rich plans encourage overutilization of health care services, as beneficiaries are generally more insulated from the high costs associated with their care.

Since the threshold is adjusted according to inflation and most health insurance premiums rise at rates greater than this, a growing proportion of plans are expected to be subjected to this tax. Recent estimates indicate that, under the most modest approach, 16% of employers would offer at least one such plan in 2018, while more aggressive estimates indicate this figure could be as high as 27%. By 2028, these estimates could rise to 36% and 54%, respectively.\(^2\) The Congressional Budget Office (CBO) has estimated that the excise tax would raise $87 billion between 2016 and 2025, a figure that is about $20 billion less than CBO’s previous estimates.\(^3\)

Concerns for Patient Organizations

Patient organizations must consider the effects of the Cadillac tax from different angles. First, many patient organizations are non-profit entities offering their employees generous health insurance coverage as a benefit. The Cadillac tax could affect their coverage as an employer. Also, organizations must be aware of the effect that the tax could have on patients enrolled in these plans. This tax is a fairly blunt approach that encourages reductions in premiums. In fact, this tax does not encourage cost containment but, rather, cost shifting. In other words, employers wishing to avoid the tax are likely to achieve lower premiums by raising the cost sharing of their coverage. With higher deductibles, copayments, and coinsurance, premiums will go down. But, higher cost sharing disproportionally affects people who use health services—those with chronic and disabling conditions. Higher premiums share the cost of care.

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\(^1\) The Affordable Care Act, Section by Section, Department of Health and Human Services, June 28, 2012, http://www.hhs.gov/healthcare/rights/law/index.html.


across a population, while lower premiums result in people with the greatest health care needs bearing the bulk of the cost.

**Employer-Sponsored Health Coverage Subject to the Tax**

The excise tax applies to various types of private insurance coverage, including insured and self-insured group health plans, wellness programs that are group health plans, flexible spending accounts (FSAs), health savings accounts (HSAs) (i.e., the employer pre-tax contributions only), health reimbursement accounts (HRAs), Archer Medical Savings Accounts (MSAs) (i.e., the employer pre-tax contributions only), on-site medical clinics providing more than de minimis care, executive physical programs, pre-tax coverage for a specified disease or illness, hospital indemnity or other fixed indemnity insurance, federal/state/local government-sponsored plans for its employees, retiree coverage, and multi-employer (Taft-Hartley) plans.

**Determining Tax Liability**

The Cadillac Tax applies to the costs exceeding the value of the threshold premium, which is adjusted to inflation annually. Employers must pay the tax if providing self-funded employee health benefits packages. Examples of the calculation of the tax liability are depicted in the graphic below.

**Congressional Activity**

In Congress, the Cadillac Tax has drawn significant attention, though opinions on the issue are not clearly divided along party lines. If the tax was repealed, Congress would need to find a vehicle to pay for the tax’s lost revenue. Legislation has been proposed to repeal the tax. H.R. 2050 would amend the IRS code of 1986 to remove language inserted by the ACA establishing the excise tax on employer-sponsored coverage. The bill has garnered bipartisan support with 132 cosponsors (118 democrats, 14 republicans) as of August 25, 2015. It was introduced to the House Ways and Means Committee on April 28, 2015, but has not yet been considered by the committee.

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Stakeholder Feedback

Economists, as well as various industry stakeholders have weighed in on the impending tax on Cadillac plans. Many groups across various industries have banded together as a coalition, called “Alliance to Fight the 40,” whose primary goal is a full repeal of the excise tax on Cadillac plans. The coalition, now registered as a lobbying group, is focused on a grassroots campaign, urging supporters to contact their Members and Senators to express their concern for the tax’s effects. The Alliance’s members cut across industries and sectors and American Benefits Council (the lead group), Pfizer, Blue Cross Blue Shield Association, Cigna, New York Life Insurance, and Towers Watson, among others.⁶

Some economists have argued that, rather than fully repeal the provisions, Congress could adjust the tax to limit its inequities, since repeal could undermine other elements of the ACA. They point to the reduced estimates for revenue the tax is expected to generate and the assumed shift in beneficiary behavior when exposed to higher cost sharing as reasons to uphold the excise tax. Many in this group concede that the tax does not necessarily target plans that simply offer exceedingly generous coverage, as some employers offer benefits with high premiums that are due to high medical costs or a disproportionately sick or older working population.⁷

Looking Forward

The Internal Revenue Service (IRS) is asking for input on the Cadillac tax.⁸ This is the second notice Treasury and the IRS have issued to provide insight into the formal rulemaking process and solicit feedback from stakeholders. The deadline for comments (including any additional comments related to the first IRS notice on this topic issued on February 23, 2015) is October 1, 2015. A proposed rule is expected in late 2015 or early 2016.

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⁶ Alliance to Fight the 40, About the Alliance, Fight the 40, http://www.fightthe40.com/aboutalliance/.