



TAX POLICY CENTER
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ANALYSIS OF BIPARTISAN POLICY CENTER (BPC) CADILLAC TAX REPLACEMENT OPTION

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The attached tables show revenue and distributional estimates for BPC's proposal to replace the "Cadillac Tax" with a limit on the income tax exclusion for employer provided health benefits and repeal of medical flexible spending accounts. The proposal increases revenues in the near term but loses revenues over the long term. In 2025, under the option that is effective in tax year 2017 (Option 1a), the proposal increases average tax burden by \$60 and has the largest impact on the middle and fourth quintiles in terms of relative change in after-tax incomes.

The findings and conclusions contained within are those of the authors and do not necessarily reflect positions or policies of the Tax Policy Center or its funders.

New Limit/Repeal MFSA Versus Cadillac Tax

The proposal replaces the excise tax on high-cost insurance plans enacted in the Affordable Care Act (the “Cadillac Tax”) with a limit on the dollar value of health insurance premiums and employer-provided health benefits that employees can exclude from taxable income.¹ The limit does not apply to earnings that can be excluded from wages subject to employer and employee payroll taxes (and the computation of future Social Security retirement and disability benefits). The limits on the exclusion of health benefits are initially lower than the Cadillac Tax benefit thresholds, but grow faster than the Cadillac tax limits, with the cross-over point where the employee exclusion limits exceed the Cadillac tax limits occurring around 2023.

The BPC proposal includes dental and vision premiums in health benefits subject to the new limits and repeals deductibility of new contributions to Medical Flexible Spending Accounts (MFSAs), while expenses subject to the Cadillac Tax include MFSAs, but do not include dental and vision premiums.

We estimate the effects of two options for phasing in the new limits on the health insurance exclusion. Option 1a limits the exclusion to amounts less than the 80th percentile of health benefits starting in tax year 2017, one year before the current law effective date of the Cadillac Tax. Option 1b imposes the same percentile limits as option 1a, but beginning in tax year 2018. For both options 1a and 1b, the limits on the exclusion are indexed to growth in GDP per capita through 2015 and to growth in GDP per capita plus 0.5 percent after 2025. Because the Option 1a limits begin one year earlier, they are always less than the Option 1b limits. In contrast, the thresholds for the Cadillac Tax are set at the 82nd percentile of health benefits for single coverage and the 84th percentile for family coverage starting in 2018 and are indexed in subsequent years to growth in the consumer price index (CPI).²

Revenue Estimates

Options 1a and 1b increase revenues by \$88 billion and \$34 billion, respectively, between fiscal years 2017 and 2025 but lose \$92 billion and \$227 billion, respectively, over the entire 2017-2035 period (Tables 1a and 1b). The proposal increases revenues in the near-term because the initial exclusion limit thresholds are lower than the Cadillac Tax thresholds, the new limits apply to dental and vision premiums, and the proposal repeals new contributions to MFSAs. However,

¹ Employees may include taxable benefits in expenses eligible under the current law itemized deduction for medical expenses in excess of 10 percent of adjusted gross income.

² Under Option 1a initial limit thresholds in 2017 are \$9,550 for single coverage and \$25,790 for family coverage. Under Option 1b initial limit thresholds in 2018 are \$9,945 for single coverage and \$26,855 for family coverage. Initial Cadillac Tax thresholds in 2018 are \$10,200 for single coverage and \$27,500 for family coverage. We did not model the age and gender adjustments of BPC thresholds nor did we model age, gender, and occupational adjustments for Cadillac Tax thresholds.

the proposal loses revenue over the long run because the exclusion limit thresholds grow faster than the Cadillac Tax thresholds.

Distributional Estimates

Under Option 1a the average tax burden increases by \$60 in 2025 as BPC's broader measure of health benefits and repeal of MFSA's more than offset higher limit thresholds than the Cadillac Tax and a generally lower effective tax rate on excess health benefits (Tables 2 and 3).³ While the average tax change in dollar terms increases with income, taxpayers in middle and upper-middle income groups (those with incomes between \$50,000 and \$200,000 when ranked by fixed dollar groups and those in the middle and fourth quintiles and bottom half of the top quintile when ranked by percentile groups) experienced the largest change in burden as a share of their after-tax income (Table 4). For example, the middle and fourth quintiles and 80-90th percentiles receive 15.4, 20.8 percent, and 13.5 percent of current law after-tax income, respectively, but pay 23.1, 27.2, and 18.1 percent of the additional tax. Similarly, the middle and fourth quintiles and 80-90th percentiles see their after-tax incomes fall by .095, .083, and 0.085 percent, respectively, as compared to a decline in after-tax income of .063 percent for all tax units. By these same measures, the lowest quintile and top one percent are impacted the least by the proposal.

Note that following TPC convention the share of compensation in the form of health benefits is fixed in the distribution estimates, but allowed to change in the revenue estimates. If the health benefits were allowed to increase in the distribution tables to reflect the higher limit thresholds in 2025 under the BPC plan, the average tax change would be about half the size (+\$24) due to the associated decline in taxable wages (with total compensation held fixed). The distributional pattern, however, would be similar, as the middle and fourth quintiles and bottom half of the top quintile would still be impacted the most.

³ After accounting for the non-deductibility of the Cadillac Tax at the insurer level and the change in taxable wages as the Cadillac Tax ultimately gets passed down to workers, the effective tax rate on excess health benefit is lower under the BPC proposal than under the Cadillac Tax for tax units below the top (39.6 percent) income tax bracket.

Table 1a. BPC Cadillac Tax Replacement Options Against Current Law Baseline (\$ billions), 2017-25¹

	2017	2018	2019	2020	2021	2022	2023	2024	2025	2017-25
Fiscal Year Revenue²										
BPC Cadillac Tax Replacement Option 1a	14.4	12.8	11.4	11.1	10.1	9.1	7.8	6.1	4.5	87.5
BPC Cadillac Tax Replacement Option 1b	--	5.7	7.9	7.2	5.9	4.5	2.8	0.8	-1.2	33.7
Calendar Year Liability										
BPC Cadillac Tax Replacement Option 1a	19.3	10.7	11.6	11.0	9.9	8.9	7.4	5.7	4.1	88.6
BPC Cadillac Tax Replacement Option 1b	--	7.6	8.0	6.9	5.5	4.2	2.4	0.3	-1.7	33.3

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version O515-v1).

(1) Baseline is current law. Proposals would repeal the excise tax on high-cost health plans, impose a limit on the income tax exclusion for employer provided health benefits, and repeal Medical Flexible Spending Accounts. Option 1a would be effective starting in 2017 and 1b would be effective starting in 2018. The exclusion limit would apply to medical, dental, vision, and supplementary indemnity insurance premiums; contributions to Health Reimbursement Arrangements and Health Savings Accounts; and the self-employed health insurance deduction. The limits would be set at the 80th percentile of health benefits in the first effective year and indexed to growth in GDP per capita before 2025 and to growth in GDP per capita plus 0.5 percentage points after 2025. Estimates include microdynamic behavioral responses: taxable income responds to changes in marginal tax rates and the share of compensation received as taxable wages responds to changes in the tax treatment of employer-provided health benefits.

(2) Estimates assume a 75-25 fiscal split, i.e. fiscal year revenue is estimated to be 25 percent of revenue from the previous calendar year plus 75 percent of revenue from the current calendar year.

Table 1b. BPC Cadillac Tax Replacement Options Against Current Law Baseline (\$ billions), 2025-35¹

	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034	2035	2025-35	2017-35
Fiscal Year Revenue²													
BPC Cadillac Tax Replacement Option 1a	4.5	1.8	-1.6	-5.0	-8.5	-11.9	-18.0	-24.9	-31.8	-38.8	-45.7	-179.8	-92.2
BPC Cadillac Tax Replacement Option 1b	-1.2	-4.2	-7.9	-11.6	-15.3	-19.1	-25.6	-33.0	-40.4	-47.8	-55.2	-261.1	-227.4
Calendar Year Liability													
BPC Cadillac Tax Replacement Option 1a	4.1	1.0	-2.4	-5.9	-9.3	-12.8	-19.7	-26.6	-33.6	-40.5	-47.4	-193.1	-104.5
BPC Cadillac Tax Replacement Option 1b	-1.7	-5.1	-8.8	-12.5	-16.3	-20.0	-27.4	-34.8	-42.2	-49.6	-57.0	-275.4	-242.2

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version O515-v1).

(1) Baseline is current law. Proposals would repeal the excise tax on high-cost health plans, impose a limit on the income tax exclusion for employer provided health benefits, and repeal Medical Flexible Spending Accounts. Option 1a would be effective starting in 2017 and 1b would be effective starting in 2018. The exclusion limit would apply to medical, dental, vision, and supplementary indemnity insurance premiums; contributions to Health Reimbursement Arrangements and Health Savings Accounts; and the self-employed health insurance deduction. The limits would be set at the 80th percentile of health benefits in the first effective year and indexed to growth in GDP per capita before 2025 and to growth in GDP per capita plus 0.5 percentage points after 2025. Estimates include microdynamic behavioral responses: taxable income responds to changes in marginal tax rates and the share of compensation received as taxable wages responds to changes in the tax treatment of employer-provided health benefits.

(2) Estimates assume a 75-25 fiscal split, i.e. fiscal year revenue is estimated to be 25 percent of revenue from the previous calendar year plus 75 percent of revenue from the current calendar year.

Table 2. BPC Cadillac Tax Replacement Option 1a

Baseline: Current Law, Distribution of Federal Tax Change by Expanded Cash Income Level, 2025¹, Summary Table

Expanded Cash Income Level (thousands of 2015 dollars) ²	Tax Units with Tax Increase or Cut ³				Percent Change in After-Tax Income ⁴	Share of Total Federal Tax Change	Average Federal Tax Change (\$)	Average Federal Tax Rate ⁵	
	With Tax Cut		With Tax Increase					Change (% Points)	Under the Proposal
	Pct of Tax Units	Avg Tax Cut	Pct of Tax Units	Avg Tax Increase					
Less than 10	0.0	0	0.2	188	0.0	0.0	0	0.0	9.2
10-20	0.6	-780	1.6	291	0.0	0.0	0	0.0	5.4
20-30	0.6	-686	2.9	374	0.0	1.5	7	0.0	6.0
30-40	1.1	-1,181	5.6	461	0.0	2.1	14	0.0	7.9
40-50	1.5	-984	8.3	542	-0.1	3.8	30	0.1	11.1
50-75	1.7	-999	14.1	563	-0.1	15.9	62	0.1	14.1
75-100	1.6	-915	17.5	589	-0.1	14.9	88	0.1	16.3
100-200	2.1	-1,272	23.2	615	-0.1	34.3	116	0.1	19.0
200-500	2.8	-882	29.8	719	-0.1	21.2	189	0.1	22.7
500-1,000	4.2	-633	26.	962	0.0	3.0	232	0.0	27.9
More than 1,000	1.7	-1,324	28.6	1,401	0.0	3.3	379	0.0	34.3
All	1.4	-1,025	12.2	611	-0.1	100.0	60	0.1	20.8

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version O515-v1).

(1) Calendar Year. Proposal would repeal the excise tax on high-cost health plans in 2018 and impose a limit on the income tax exclusion for employer provided health benefits and repeal Medical Flexible Spending Accounts in 2017. The exclusion limit would apply to medical, dental, vision, and supplementary indemnity insurance premiums; contributions to Health Reimbursement Arrangements and Health Savings Accounts; and the self-employed health insurance deduction. The limits would be set at the 80th percentile of health benefits in 2017 and indexed to growth in GDP per capita between 2018 and 2025 and to growth in GDP per capita plus 0.5 percentage points after 2025. Health benefits are held constant at baseline levels. For

a description of TPC's current law baseline, see <http://www.taxpolicycenter.org/taxtopics/Baseline-Definitions.cfm>
(footnotes continue on next page)

(2) Includes both filing and non-filing units but excludes those that are dependents of other tax units. Tax units with negative adjusted gross income are excluded from their respective income class but are included in the totals. For a description of expanded cash income, see <http://www.taxpolicycenter.org/TaxModel/income.cfm>

(3) Includes tax units with a change in federal tax burden of \$10 or more in absolute value.

(4) After-tax income is expanded cash income less: individual income tax net of refundable credits; corporate income tax; payroll taxes (Social Security and Medicare); estate taxes; and excise taxes.

(5) Average federal tax (includes individual and corporate income tax, payroll taxes for Social Security and Medicare, the estate tax, and excise taxes) as a percentage of average expanded cash income.

Table 3. BPC Cadillac Tax Replacement Option 1a
Baseline: Current Law, Distribution of Federal Tax Change by Expanded Cash Income Percentile, 2025¹, Summary Table

Expanded Cash Income Percentile ^{2,3}	Tax Units with Tax Increase or Cut ⁴				Percent Change in After-Tax Income ⁵	Share of Total Federal Tax Change	Average Federal Tax Change (\$)	Average Federal Tax Rate ⁶		
	With Tax Cut		With Tax Increase					Change (% Points)	Under the Proposal	
	Pct of Tax Units	Avg Tax Cut	Pct of Tax Units	Avg Tax Increase						
Lowest Quintile	0.4	-710	1.5	328	0.0	0.9	2	0.0	5.8	
Second Quintile	1.2	-1,027	6.3	489	0.0	7.0	19	0.0	9.3	
Middle Quintile	1.8	-987	15.0	575	-0.1	23.1	69	0.1	14.8	
Fourth Quintile	1.9	-1,250	20.8	587	-0.1	27.2	98	0.1	17.8	
Top Quintile	2.5	-942	28.0	736	-0.1	41.7	183	0.0	26.6	
All	1.4	-1,025	12.2	611	-0.1	100.0	60	0.1	20.8	
Addendum										
80-90	2.0	-1,092	26.4	663	-0.1	18.1	153	0.1	20.6	
90-95	2.9	-874	30.0	692	-0.1	10.4	182	0.1	22.0	
95-99	3.7	-750	30.0	824	-0.1	9.4	220	0.0	25.2	
Top 1 Percent	1.7	-1,280	28.3	1,371	0.0	3.9	367	0.0	34.0	
Top 0.1 Percent	1.4	-1,215	27.8	2,096	0.0	0.6	567	0.0	35.0	

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0515-v1).

(1) Calendar Year. Proposal would repeal the excise tax on high-cost health plans in 2018 and impose a limit on the income tax exclusion for employer provided health benefits and repeal Medical Flexible Spending Accounts in 2017. The exclusion limit would apply to medical, dental, vision, and supplementary indemnity insurance premiums; contributions to Health Reimbursement Arrangements and Health Savings Accounts; and the self-employed health insurance deduction. The limits would be set at the 80th percentile of health benefits in 2017 and indexed to growth in GDP per capita between 2018 and 2025 and to growth in GDP per capita plus 0.5 percentage points after 2025. Health benefits are held constant at baseline levels. For a description of TPC's current law baseline, see <http://www.taxpolicycenter.org/taxtopics/Baseline-Definitions.cfm> (footnotes continue on next page)

(2) Includes both filing and non-filing units but excludes those that are dependents of other tax units. Tax units with negative adjusted gross income are excluded from their respective income class but are included in the totals. For a description of expanded cash income, see <http://www.taxpolicycenter.org/TaxModel/income.cfm>

(3) The income percentile classes used in this table are based on the income distribution for the entire population and contain an equal number of people, not tax units. The breaks are (in 2015 dollars): 20% \$26,106; 40% \$51,109; 60% \$87,706; 80% \$148,149; 90% \$217,364; 95% \$289,948; 99% \$848,445; 99.9% \$5,233,860.

(4) Includes tax units with a change in federal tax burden of \$10 or more in absolute value.

(5) After-tax income is expanded cash income less: individual income tax net of refundable credits; corporate income tax; payroll taxes (Social Security and Medicare); estate tax; and excise taxes.

(6) Average federal tax (includes individual and corporate income tax, payroll taxes for Social Security and Medicare, the estate tax, and excise taxes) as a percentage of average expanded cash income.

Table 4. Supplemental: Share of Tax Change and Percent Change in After-Tax Income by Income Percentile, 2025¹

Expanded Cash Income Percentile ^{2,3}	Share of After-Tax Income ⁴	Share of Total Federal Tax Change ⁵	Percent Change in After-Tax Income
Lowest Quintile	5.0	0.9	-0.011
Second Quintile	10.1	7.0	-0.044
Middle Quintile	15.4	23.1	-0.095
Fourth Quintile	20.8	27.2	-0.083
Top Quintile	48.9	41.7	-0.054
All	100.0	100.0	-0.063
Addendum			
80-90	13.5	18.1	-0.085
90-95	8.8	10.4	-0.075
95-99	10.9	9.4	-0.055
Top 1 Percent	15.7	3.9	-0.016
Top 0.1%	6.8	0.6	-0.006

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0515-v1).

(1) Calendar Year. Proposal would repeal the excise tax on high-cost health plans in 2018 and impose a limit on the income tax exclusion for employer provided health benefits and repeal Medical Flexible Spending Accounts in 2017. The exclusion limit would apply to medical, dental, vision, and supplementary indemnity insurance premiums; contributions to Health Reimbursement Arrangements and Health Savings Accounts; and the self-employed health insurance deduction. The limits would be set at the 80th percentile of health benefits in 2017 and indexed to growth in GDP per capita between 2018 and 2025 and to growth in GDP per capita plus 0.5 percentage points after 2025. Health benefits are held constant at baseline levels.

(2) Includes both filing and non-filing units but excludes those that are dependents of other tax units. Tax units with negative adjusted gross income are excluded from their respective income class but are included in the totals. For a description of expanded cash income, see <http://www.taxpolicycenter.org/TaxModel/income.cfm>

(3) The income percentile classes used in this table are based on the income distribution for the entire population and contain an equal number of people, not tax units. The breaks are (in 2015 dollars): 20% \$26,106; 40% \$51,109; 60% \$87,706; 80% \$148,149; 90% \$217,364; 95% \$289,948; 99% \$848,445; 99.9% \$5,233,860.

(4) After-tax income is expanded cash income less: individual income tax net of refundable credits; corporate income tax; payroll taxes (Social Security and Medicare); estate tax; and excise taxes.

(5) Average federal tax (includes individual and corporate income tax, payroll taxes for Social Security and Medicare, the estate tax, and excise taxes) as a percentage of average expanded cash income.



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