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## DISTRIBUTIONAL IMPACT OF REPEALING THE EXCISE TAX ON HIGH-COST HEALTH PLANS

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### ABSTRACT

TPC has estimated the distributional impact of repealing the Affordable Care Act's "Cadillac tax" in 2018 and 2025. While the average tax cut increases with income throughout the distribution, the middle and fourth income quintiles receive the largest share of the tax benefit compared with their shares of after-tax income.

*Note: The tables that accompany this paper are: [T15-0096](#), [T15-0097](#), [T15-0098](#), [T15-0099](#), [T15-0100](#), [T15-0101](#), [T15-0102](#), [T15-0103](#).*

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

## ***What is the Cadillac Tax?***

Under the Affordable Care Act, employer-sponsored health benefits whose value exceeds certain thresholds will be subject to an excise tax starting in 2018. The “Cadillac tax” will equal 40 percent of the value of health benefits exceeding \$10,200 for single coverage and \$27,500 for family coverage in 2018 with the thresholds indexed to growth in the consumer price index in subsequent years.<sup>1</sup> The Cadillac tax will apply to employer and employee contributions to health insurance premiums plus contributions to Health Saving Accounts, Health Reimbursement Arrangements, and Medical Flexible Spending Accounts.

## ***Workers Bear the Burden***

The tax will be levied on insurance companies but the burden will likely translate into higher premiums that are passed on to workers in the form of reduced wages.<sup>2</sup> In many cases employers will avoid the tax by switching to less expensive health plans, consequently increasing wages and workers’ income and payroll taxes. In fact, the Joint Committee on Taxation (JCT) and the Congressional Budget Office (CBO) predict that three-quarters of the revenue raised by the Cadillac tax will be through this indirect channel (higher income and payroll taxes) rather than excise taxes collected from insurers.

## ***Distributional Estimates in 2018***

Table [T15-0096](#) shows distributional estimates of the static effect of repealing the Cadillac tax in 2018, assuming health insurance premiums projected under current law remain unchanged. These projected premiums reflect an assumption that most employers will offer plans with premiums below the Cadillac tax thresholds under current law. Since in these baseline projections few employers who previously offered “excessive” health plans will in fact pay the tax, only 0.9 percent of tax units receive tax cuts and the average tax cut among all tax units is only \$9. While the average tax cut increases with income throughout the distribution, the middle and fourth income quintiles receive the largest share of the tax benefit compared with their shares of after-tax income. For example, the middle and fourth quintiles receive 20.7 and 28.2 percent of the tax cuts, compared with only 15.1 and 21.1 percent of current law after-tax income, (see detail table in [T15-0096](#)).

The static effect, however, tells only part of the story, as this table shows no impact of the Cadillac tax on workers whose employers avoided the tax by switching to cheaper health plans, thereby substituting taxable wages for tax-free health benefits and increasing employees’ tax

<sup>1</sup> The thresholds are indexed to CPI-U + plus one percentage point in 2019 and to CPI-U in subsequent years

<sup>2</sup> The net burden of the excise tax will likely be offset by reduced income and payroll taxes when wages decline.

liabilities. Table [T15-0098](#) shows the effects on tax payments by income group if health insurance premiums revert to pre-Cadillac tax levels when the tax is repealed. In addition to showing the impact on workers no longer bearing the direct burden of the excise tax in the form of lower wages, table [T15-0098](#) shows the impact on workers at firms reverting to more expensive health plans, substituting additional tax-free health benefits for lower wages and thereby reducing their employees' income and payroll tax liabilities.

Accounting for the indirect effect of repealing the tax on premiums greatly increases the share of tax units affected and the average tax cut. Over 6 percent of tax units receive tax cuts and the average tax cut across all tax units is \$54. Again, the middle and fourth quintiles receive a disproportionate share of the tax cuts, 24.6 and 28.9 percent, respectively, relative to their shares of after-tax income. The lowest and second income quintiles receive smaller shares of the tax cuts when accounting for the indirect effect of the Cadillac tax than when just considering the static effect (1.2 and 7.4 percent versus 2.7 and 11.2 percent). This occurs because workers in lower tax brackets benefit relatively less than workers in higher tax brackets when employers shift compensation from wages to non-taxable health benefits.

### ***Distributional Estimates in 2025***

Because the thresholds for the tax increase with the consumer price index, which is projected to grow more slowly than health care costs, the number of tax units and portion of health insurance premiums subject to the Cadillac tax expands rapidly over time. By 2025, we project the share of tax units affected by repealing the tax will be about twice as high as in 2018 and the average tax change will be nearly four times as high as in the first year. When holding premiums fixed at post-Cadillac tax levels, 1.7 percent of tax units receive tax cuts and the average tax cut is \$34 (See table [T15-0100](#)). When allowing premiums to revert to pre-Cadillac tax levels, 12.8 percent of tax units see tax cuts and the average tax cut is \$208 (see table [T15-0102](#)). As in 2018 the middle and fourth quintiles receive larger shares of the tax cut from repeal than their shares of current law after-tax income.



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