

# Key Elements of the U.S. Tax System

What is the Cadillac tax?

TAXES AND HEALTH CARE

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## Q. What is the Cadillac tax?

**A. Employer-sponsored health benefits whose value exceeds legally specified thresholds will be subject to a 40 percent excise tax, starting in 2022. The so-called Cadillac tax will be levied on insurance companies, but the burden will likely fall on workers. The tax will effectively limit the tax preference for employer-sponsored health insurance.**

### TAX ON HIGH-COST HEALTH PLANS STARTING IN 2022

Under the Affordable Care Act, employer-sponsored health benefits whose value exceeds specified thresholds will be subject to an excise tax starting in 2022. (The Cadillac tax was originally scheduled to take effect in 2018 but has been delayed twice by legislation, most recently by the Extension of Continuing Appropriations Act of January 2018.) This “Cadillac tax” will equal 40 percent of the value of health benefits exceeding thresholds projected to be \$11,200 for single coverage and \$30,150 for family coverage in 2022. The thresholds will be indexed to growth in the consumer price index in subsequent years. Thresholds will be higher for plans with more-expensive-than-average demographics, retirees ages 55 to 64, and workers in high-risk professions. The Cadillac tax will apply not only to employers’ and employees’ contributions to health insurance premiums, but also to 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 be passed on to workers in the form of lower wages. Some employers will avoid the tax by switching to less expensive health plans; this will translate into higher wages but also higher income and payroll taxes. In fact, the Joint Committee on Taxation and the Congressional Budget Office predict that 70 percent of the revenue raised by the Cadillac tax will be through the indirect channel of higher income and payroll taxes, rather than through excise taxes collected from insurers. Simulations suggest the excise tax will have the largest relative impact on after-tax income for families in the middle income quintile.

### EFFECTIVELY LIMITS THE ESI EXCLUSION

Employer-provided health benefits are excluded from taxable income, reducing income and payroll tax revenue by an estimated \$280 billion in 2018. Even if one ignores the revenue losses, there are other undesirable aspects of the exclusion. The exclusion for employer-sponsored health insurance (ESI) is poorly targeted, as it is worth more to taxpayers in higher brackets who would be more likely to purchase insurance in the first place. Additionally, the ESI exclusions’ open-ended nature may contribute to faster health care

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cost growth. For these reasons, analysts have often suggested limiting the ESI exclusion by including the value of health benefits beyond a certain threshold in taxable income (Congressional Budget Office 2016).

While the Cadillac tax plan is not a direct limit, it effectively curtails the ESI exclusion. If employers avoid the excise tax by shifting compensation from health benefits to taxable wages, the ultimate impact will be identical to an exclusion limit. In both cases, health benefits that exceeded thresholds before introduction of the Cadillac tax would become subject to income and payroll taxes. If employers continue to offer high-cost health plans, the impact will be similar to an exclusion limit—though less progressive. Excess benefits would be taxed at 40 percent rather than at an individual worker’s marginal tax rate. (After accounting for income and payroll tax offsets, the effective excise tax rate is ultimately lower than 0.4 and, in fact, declines with income (Blumberg, Holahan, and Mermin 2015).)

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#### Data Sources

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#### Further Reading

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