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# Why Congress Shouldn't Repeal the Cadillac Tax

## But If It Does, It Should Offset the Cost

By Paul N. Van de Water

The House is likely to vote soon on a bill to repeal the excise tax on high-cost health plans (the so-called "Cadillac tax").[1] That would be unwise for two reasons: it would set back efforts to slow the growth of health care costs, and it would lose substantial needed revenue. If the House does vote to repeal the tax, it should follow its pay-as-you-go procedure and not add the bill's cost to the budget deficit.

The Affordable Care Act (ACA) imposed a 40 percent excise tax on the value of employer-sponsored health plans that exceeds certain high thresholds (about $11,200 for individuals and $30,100 for families in 2022). Higher dollar limits apply to retirees and workers in certain high-risk occupations, and the thresholds are adjusted for the age and gender make-up of each employer's workforce. The tax was originally set to take effect in 2018, but lawmakers have twice delayed it. It is now scheduled to begin in 2022. Repealing the tax would cost approximately $193 billion through 2029,[2] but that understates its long-term cost. The cost of repeal rises rapidly in the long run, totaling as much as $1 trillion in the 2030s.[3]

Initially, the excise tax will affect few workers and health plans, primarily those with low cost sharing and generous benefits, and the tax will apply to an even smaller fraction of plan costs — just 4 percent of such costs in 2026. It generally will not affect plans with high deductibles or restrictive benefits.

Because the tax thresholds are indexed to consumer prices rather than health costs, the tax could eventually affect too large a share of health plans. But important changes proposed by the Obama Administration would fix this and other flaws in the tax, and would do so at a far lower budgetary cost than repeal, while continuing to provide a brake on health care spending.

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[1] "Middle Class Health Benefits Tax Repeal Act of 2019," H.R. 748, https://www.congress.gov/bill/116th-congress/house-bill/748.

[2] Congressional Budget Office, *Federal Subsidies for Health Insurance Coverage for People Under Age 65: 2019 to 2019*, May 2, 2019, Table 2-1, https://www.cbo.gov/system/files/2019-05/55085-HealthCoverageSubsidies_0.pdf.

[3] Committee for a Responsible Federal Budget, *Lawmakers Shouldn't Repeal Cadillac Tax Without Substantial Offsets,* June 13, 2019, http://www.crfb.org/blogs/lawmakers-shouldnt-repeal-cadillac-tax-without-substantial-offsets.

Moreover, repealing the excise tax would primarily benefit higher-income taxpayers, who are more likely to have expensive health plans and pay higher marginal tax rates. If the tax were repealed and the cost not offset, the resulting higher deficits would be likely, over time, to impede needed investments and increase pressures to cut programs on which many low- and moderate-income families rely.

## Excise Tax Will Help Slow Health Cost Growth

The excise tax has a strong policy rationale: it will help slow health care cost growth. In fact, it's one of the ACA's most important cost-containment measures. It will discourage employers and employees from buying unusually high-cost health coverage that promotes the excess use of health care. And the Congressional Budget Office (CBO) has concluded it will "encourage the dissemination of less costly ways to deliver appropriate medical services."[4] In addition, reducing the growth of health insurance premiums will allow for larger wage increases.

Health policy experts of all political persuasions have long viewed the unlimited exclusion of employer-financed health insurance from income and payroll taxes as economically inefficient and regressive. The excise tax effectively limits the tax exclusion. It will thereby "help curtail the growth of private health insurance premiums by encouraging employers to limit the costs of plans to the tax-free amount," according to a statement by 101 prominent health economists and policy analysts.[5]

Initially, the excise tax won't affect most workers and health plans, since its thresholds substantially exceed the value of the typical employer health plan. In the absence of the tax, roughly 15 percent of people with employer-sponsored health coverage in 2022 would be enrolled in plans whose costs exceeded the thresholds, CBO estimates. CBO expects that actions by employers and employees to reduce the cost of health plans in response to the tax will lower that share, however.[6] Moreover, the tax will apply to only a small portion of plan costs. Even by 2026, only 4 percent of estimated total plan costs will exceed the thresholds.[7]

Critics of the excise tax contend that it will encourage health plans to increase cost sharing even though typical deductibles are already high, and "inadequate ESI [employer-sponsored insurance] is a serious national problem."[8] But this critique is overblown. The Cadillac tax will not affect the typical health plan, as we have pointed out, and the plans that it will affect are by no means "inadequate." The excise tax will only affect plans that have unusually generous cost sharing or benefit designs or are unusually expensive for other reasons.

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[4] Congressional Budget Office, Letter to the Honorable Evan Bayh, November 30, 2009, p. 26 https://www.cbo.gov/sites/default/files/111th-congress-2009-2010/reports/11-30-premiums.pdf.

[5] Center on Budget and Policy Priorities, *Health Policy Experts' Statement about Excise Tax on High-Cost Plans*, October 1, 2015, https://www.cbpp.org/health-policy-experts-statement-about-excise-tax-on-high-cost-plans.

[6] Congressional Budget Office, *Options for Reducing the Deficit: 2019 to 2028*, December 2018, Revenues — Option 12, https://www.cbo.gov/publication/54667.

[7] Jason Furman and Matthew Fielder, "The Cadillac Tax — A Crucial Tool for Delivery System Reform," *New England Journal of Medicine*, March 17, 2016, pp. 1008-9, https://www.nejm.org/doi/full/10.1056/NEJMp1514970.

[8] Stan Dorn, "The Cadillac Tax: It's Time to Kill This Policy Zombie," *Health Affairs* Blog, June 18, 2019, https://www.healthaffairs.org/do/10.1377/hblog20190617.795057/full/.

## Tax Can Spur Employers to Negotiate Lower Health Care Prices

Although employers with high-cost plans could respond to the excise tax by increasing beneficiary cost sharing, the tax can also spur employers and plan administrators to negotiate lower payment rates with hospitals and other health care providers and to encourage their employees to use providers that deliver care at lower cost. As economists and former Obama Administration officials Jason Furman and Matthew Fiedler have written:

> Many employers will probably focus instead [of increasing cost sharing] on encouraging more efficient care delivery, by deploying innovative payment models, directly complementing public-sector efforts, and finding creative ways to steer patients toward more efficient providers — investments that were often difficult to justify when the federal government was picking up much of the tab for inefficient care. In addition, health care markets — including pharmaceutical, physician, hospital, and insurance markets — feature sellers with substantial market power. By increasing employers' incentives to negotiate for better prices and steer enrollees toward lower priced providers, the tax will help check that market power and drive prices down.[9]

The savings at stake from these strategies could be significant. Recent research reveals that insurers often pay substantially different prices for the same health care service. For example, the average price paid for delivering a baby is $3,600 in the Knoxville, Tennessee, metropolitan area and $13,400 in San Francisco. Large variation can also occur within an area. In metropolitan San Francisco, the price of a delivery ranges from $11,100 at the 10th percentile to $23,900 at the 90th percentile.[10]

Even more surprising, prices vary greatly within individual hospitals. That is, different insurers pay very different prices for the same service at the same hospital. For example, researchers have found price differences as large as 40 and 65 percent for magnetic resonance imaging at two large hospitals.[11]

"The wide variation in hospital prices represents an important opportunity for employers to save money," according to a new RAND study. Moreover, "the Cadillac tax offers an opportunity for employers to demand price concessions from providers in their health plans and to convey to employees the urgent necessity to reduce health benefit costs. The Cadillac tax, as currently formulated in federal law, sets an effective ceiling on the cost of employer health benefits, and employers could legitimately demand that their provider contracts be renegotiated to remain under that ceiling."[12]

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[9] Furman and Fiedler.

[10] Kevin Kennedy *et al.*, *Past the Price Index: Exploring Actual Prices Paid for Specific Services by Metro Area*, Health Care Cost Institute, April 30, 2019, https://www.healthcostinstitute.org/blog/entry/hmi-2019-service-prices.

[11] Zack Cooper *et al.*, "The Price Ain't Right? Hospital Prices and Health Spending on the Privately Insured," *Quarterly Journal of Economics*, February 2019, https://isps.yale.edu/sites/default/files/publication/2018/05/cooper_20180507_variationmanuscript_0_1.pdf.

[12] Chapin White and Christopher Whaley, *Prices Paid to Hospitals by Private Health Plans Are High Relative to Medicare and Vary Widely*, RAND Corporation, May 2019, https://www.rand.org/pubs/research_reports/RR3033.html.

Reducing the variability in provider payment rates could significantly lower the cost of health coverage. For example, after finding 4-to-1 differences in payments across hospitals, the Montana state employee plan moved to a system in which it pays hospitals a multiple of Medicare rates. In so doing, it saved $17 million in the first 18 months, or more than 5 percent of total plan spending.[13]

## Alternatives to Repeal

Instead of repealing the excise tax, policymakers should either adjust it to address certain concerns that have been raised, as the Obama Administration proposed, or replace it with a comparable measure to help contain health care costs, such as a well-designed cap on the tax exclusion for employer-based health coverage.

The excise tax has some flaws that, while significant, can readily be fixed. Its dollar thresholds rise each year with the Consumer Price Index, which grows more slowly than health care costs do, so the tax will eventually affect too large a share of health plans. In addition, the tax could fall on some plans that are expensive because they cover people in high-cost areas, not because they're overly generous. And while price variations can provide an opportunity for savings, geographic differences are not going to disappear.

A proposal advanced in the Obama Administration's fiscal year 2017 budget addressed both of these concerns. It would not allow the tax's thresholds in any state to fall below the average premium for a "gold" plan in the state's health insurance marketplace. *This change would ensure that the thresholds eventually grow at the same rate as health insurance premiums and that the tax wouldn't affect an ever-increasing share of health plans.* This change also would effectively adjust the tax's thresholds for geographic differences in health care costs.[14]

A bipartisan group of scholars from the American Enterprise Institute and the Brookings Institution recently suggested another alternative — capping the tax exclusion. "We urge Congress either to allow the Cadillac tax to take effect or to legislate a cap on the tax exclusion, so that premiums above the cap would be treated as income to covered workers," they wrote. "Further delays, or repealing the tax outright without a substitute that limits the tax exclusion, would leave in place the current incentives that increase spending rather than value in health care."[15]

## Paying for Reform or Repeal

Repealing the Cadillac tax would primarily benefit upper-income taxpayers. That's because they are more likely to have expensive employer-sponsored health plans and face higher marginal tax rates. Almost three-quarters of the tax cut would benefit those in the top two quintiles of the

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[13] Marshall Allen, "In Montana, a Tough Negotiator Proved Employers Don't Have to Pay So Much for Health Care," ProPublica, October 2, 2018, https://www.propublica.org/article/in-montana-a-tough-negotiator-proved-employers-do-not-have-to-pay-so-much-for-health-care.

[14] Furman and Fiedler.

[15] Henry Aaron *et al.*, "Cost-reducing health policies: A response to Chairman Alexander and the Senate Committee on Health, Education, Labor, and Pensions," American Enterprise Institute and the Brookings Institution, March 1, 2019, https://www.aei.org/publication/cost-reducing-health-policies/.

income distribution, according to the Tax Policy Center. Only 7 percent of the tax savings would accrue to those in the bottom two income quintiles.[16]

Reforming the excise tax to address its shortcomings would be much less costly than repealing it. Improving the tax along the lines the Obama Administration suggested would cost $8 billion from 2020-2026, according to the Joint Committee on Taxation (costs would grow in later years).[17] That cost could be offset relatively easily by other changes in revenues or health spending. Depending on the design of the policy, limiting the tax exclusion for employer-sponsored health insurance could fully offset or more than offset the cost of repealing the excise tax.[18]

Because of the pressures it would put on deficits and the debt — in addition to the those from an aging population, rising health care costs, and the ill-advised 2017 tax cuts — repealing the excise tax without paying for it would be unwise. Doing so would leave even fewer tax resources available to pay for badly needed public investments and would lead over time to substantially greater chances that cuts would be made in valuable programs. Any plan to repeal the Cadillac tax should therefore adhere to the House's pay-as-you-go rule, which requires that any direct spending or revenue legislation not add to the deficit. And since repealing the tax would represent a largely regressive tax cut, if repeal legislation moves forward on Capitol Hill, it should be fully offset by progressive revenue-raising measures.

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[16] Tax Policy Center, *Repeal Cadillac Tax, Premiums Revert to Pre-Cadillac Tax Levels*, Table T18-0217, https://www.taxpolicycenter.org/model-estimates/distribution-cadillac-tax-oct-2018/t18-0217-repeal-cadillac-tax-premiums-revert-pre.

[17] Joint Committee on Taxation, *Estimated Budget Effects Of The Revenue Provisions Contained In The President's Fiscal Year 2017 Budget Proposal*, JCX-15-16, March 24, 2016, https://www.jct.gov/publications.html?func=startdown&id=4881.

[18] CBO, *Options for Reducing the Deficit.*