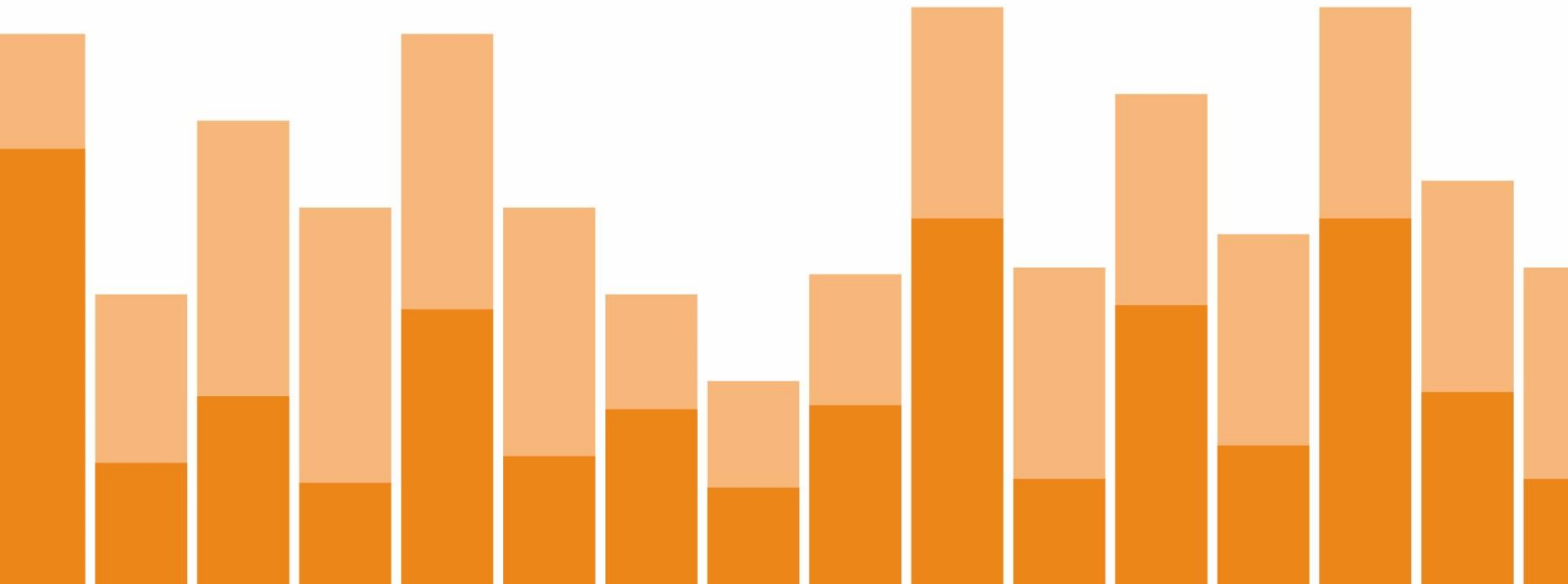
AMERICAN
HEALTH
POLICY
INSTITUTE

ACA Excise Tax: Cutting Family Budgets, Not Health Care Budgets

By Tevi D. Troy and D. Mark Wilson



American Health Policy Institute (AHPI) is a non-partisan 501(c)(3) think tank, established to examine the impact of health policy on large employers, and to explore and propose policies that will help bolster the ability of large employers to provide quality, affordable health care to employees and their dependents. The Affordable Care Act has catalyzed a national debate about the future of health care in the United States, and the Institute serves to provide thought leadership grounded in the practical experience of America's largest employers. To learn more, visit americanhealthpolicy.org.

Contents

Executive Summary 1

The ACA Excise Tax Provision 2

How Many Employers Will Be Impacted By The Tax? 2

What Changes Are Employers Making To Their Plans In Response To The Tax? 3

What Impact Will the Excise Tax Have On Wages? 4

How Much Revenue Will The Excise Tax Actually Generate? 5

Conclusion 5

Endnotes 6

Executive Summary

Under the Affordable Care Act (ACA), in 2018, an excise tax on high-value employer-provided health plans, the so-called "Cadillac tax," takes effect. Even before 2018, though, the excise tax is already driving many employers to fundamentally reassess their health care plans. While the tax was intended to reduce health care spending, its impact in the real world is being felt by workers who are seeing the value of their health care plans reduced.

Given the significant debate around the potential reform and repeal of the health care excise tax as the 2016 presidential election nears, the American Health Policy Institute conducted two new surveys of large employers, in June and September of 2015, to identify how many of them will be impacted by the excise tax and what steps companies are planning to take to minimize their exposure to the tax.[1] The new surveys found that the excise tax is already having, and will continue to have a significant impact:

- Almost 90 percent of large employers are taking steps to try to prevent their company from having a plan that triggers the excise tax in 2018;
- Over 30 percent of large employers said they would have at least one plan impacted by the excise tax in 2018;
  - Almost half of the employers that did not have plans hitting the excise tax in 2018 said they would have a plan that would be impacted by 2023;
- Almost 19 percent of large employers were already curtailing or eliminating employee contributions to flexible spending accounts (FSAs) in order to avoid triggering the excise tax;
- Almost 13 percent were already curtailing or eliminating employee contributions to health savings accounts (HSAs);
- Among employers who are going to reduce the values of their plans as a result of the excise tax, 71 percent of employers said that they probably would not provide a corresponding wage increase; 16 percent said they would.

Moreover, as predicted by the Congressional Budget Office (CBO), other surveys show 38 percent of employers plan to reduce the value of their health benefits in 2016 to reduce their exposure to the excise tax.[2] According to the Kaiser 2015 Employer Health Benefits Survey, 64 percent of large employers (200 or more employees) have increased cost sharing, 18 percent have increased incentives to use less costly providers, and 10 percent have reduced the scope of covered health services in order to reduce their exposure to the tax.[3]

As these numbers show, the excise tax continues to be an important health policy issue and is going to impose real costs on both employees and employers alike. Some health care policy theorists say that the excise tax will curtail health care expenditures. Health care policy realists understand that solving the excise tax facing many employers as well as making changes to future payment policies are necessary to stave off a potential collapse of the employer-sponsored health insurance—a system that 175 million Americans rely on for health care. As this paper demonstrates, it would seem prudent for policymakers to act in response to the realities of imposition of the excise tax.

The ACA Excise Tax Provision

Under the Affordable Care Act (ACA), if the aggregate cost of employer-sponsored health insurance coverage for an employee or a retiree (including surviving spouses) exceeds $10,200 for individual coverage and $27,500 for family coverage, a non-deductible 40 percent excise tax is applied to the amount of the employee benefit that exceeds the tax threshold.[4] The tax is scheduled to go into effect in 2018. In 2019, the threshold amounts for the excise tax are increased by the Consumer Price Index (CPI) plus one percentage point. In 2020 and thereafter, the threshold amounts are indexed by just the CPI.

It is important to remember that the excise tax does not just apply to the portion of premiums paid by employers. The aggregate cost of the employee benefit is defined quite broadly, including employer-paid premiums to be sure, but also tax-free employee premium contributions, reimbursements under a flexible spending account (FSA) for medical expenses, health reimbursement arrangements (HRAs), employer contributions to a health savings account (HSA), and on-site medical clinics that offer more than a *de minimis* amount of medical care to employees.

How Many Employers Will Be Impacted By The Tax?

Several recent reports show that a large number of employer health care plans will be impacted by the excise tax in 2018, and that number will grow significantly over time. In June 2015, the American Health Policy Institute confidentially surveyed members of the HR Policy Association to identify how many will be impacted by the excise tax and what steps they are planning to take to minimize their exposure to the tax. The survey found that the tax would have wide ranging effects on employer nationwide:

- Over 30 percent said they would have at least one plan impacted by the excise tax in 2018;
- Almost half of the employers that did not have plans hitting the excise tax in 2018 said they would have a plan that would be impacted by 2023; and
- Almost 90 percent of large employers are taking steps to try to prevent their company from having a plan that triggers the excise tax in 2018.[5]

The Institute's survey results are consistent with other surveys that found 31 of employers would be impacted in 2018,[6] and a recent survey of large employers by the National Business Group on Health (NBGH) that found 48 percent of large employers expect one of their plans to hit the tax threshold in 2018 *if no changes were made to their plan.*[7] The NBGH survey also found that among large employers that will be able to delay the impact of the tax by making plan design changes, the median delay is only 3 years for their first plan to hit the tax, and that even with plan design changes, 28 percent of large employers say they will still have one plan that is impacted by the tax in 2018.[8]

As the Institute's November 2014 study shows, over time, more and more employer plans will be impacted by the excise tax because the cost of employer-sponsored health benefits typically increases faster than other prices even with careful plan management. For example, while medical care prices are currently rising at a relatively low rate (2.4 percent in 2014), they are still rising

significantly faster than all other prices (1.6 percent).[9] Because the threshold for the excise tax increases over time by the CPI and not medical inflation, by 2031, the cost of today's "average plan" will hit the threshold for the excise tax.

In this regard, the high-cost excise tax is similar to the Alternative Minimum Tax (AMT) which was originally intended to target only 155 high-income households, but now impacts 4.2 million households with incomes of $83,400 and above.[10] Because of the way the high-cost excise tax is indexed to inflation, the steady increase in health care costs will in short order cause many middle class health plan beneficiaries to be subjected to the excise tax.

What Changes Are Employers Making To Their Plans In Response To The Tax?

Congress intended the excise tax to reduce the cost, and therefore the value, of employer health care plans, and the tax is indeed is having this anticipated effect. During the ACA debate, the Joint Committee on Taxation (JCT) and CBO told Congress that both individuals and employers would seek less costly policies "through some combination of greater cost sharing (which would lower premiums directly and also lower them indirectly by leading to less use of medical services), more stringent benefit management, or coverage of fewer services."[11] This "combination" will have substantial impacts on employees' health care costs.

Because of the way the excise tax is structured, employers have an incentive to limit their employees' ability to select benefit options that have the potential to trigger the tax, such as employee contributions to FSAs that can add up to $2,700 to the value of a health plan.[12] For example, an employee with a plan that costs $9,000 in 2018 for individual coverage with no FSA option would not trigger the excise tax, while a similar employee with an FSA option that permits a payroll deduction of up to $2,700, could trigger a tax on the employer of $400 simply by exercising their option to put $2,200 into the FSA.

In September 2015, the American Health Policy Institute confidentially surveyed members of the HR Policy Association to identify how many large employers where curtailing or eliminating employee contributions to FSAs and health savings accounts in order to avoid triggering the excise tax in 2018. The survey found:

- Almost 19 percent of large employers were already curtailing or eliminating employee contributions to FSAs in order to avoid triggering the excise tax; and
- Almost 13 percent were already curtailing or eliminating employee contributions to HSAs.

Moreover, as predicted by the JCT and CBO, 38 percent of employers plan to reduce the value of their health benefits in 2016 to reduce their exposure to the excise tax.[13] According to the Kaiser 2015 Employer Health Benefits Survey, 64 percent of large employers (200 or more employees) have increased cost sharing; 18 percent have increased incentives to use less costly providers; and 10 percent have reduced the scope of covered health services.[14]

While health economists may view all of these changes as positive and necessary for reducing the nation's health care spending, employees may have a very different view. According to one recent poll, the number one concern among those with health insurance is the size of their deductible, which will likely increase as employers adjust plan values to avoid the excise tax thresholds.[15]

Employers share these affordability concerns as well, but are faced with an impending tax that leaves them no option but to reduce the value of the health care benefits they provide to their employees. Although the excise tax may have been sold as a tax on overly generous "Cadillac" health benefits, in reality it is impacting ordinary health plans that are expensive simply because they are offered in high-cost areas, or because they cover large numbers of people whose health costs are higher than average—women, older and disabled workers, and families experiencing catastrophic health events.

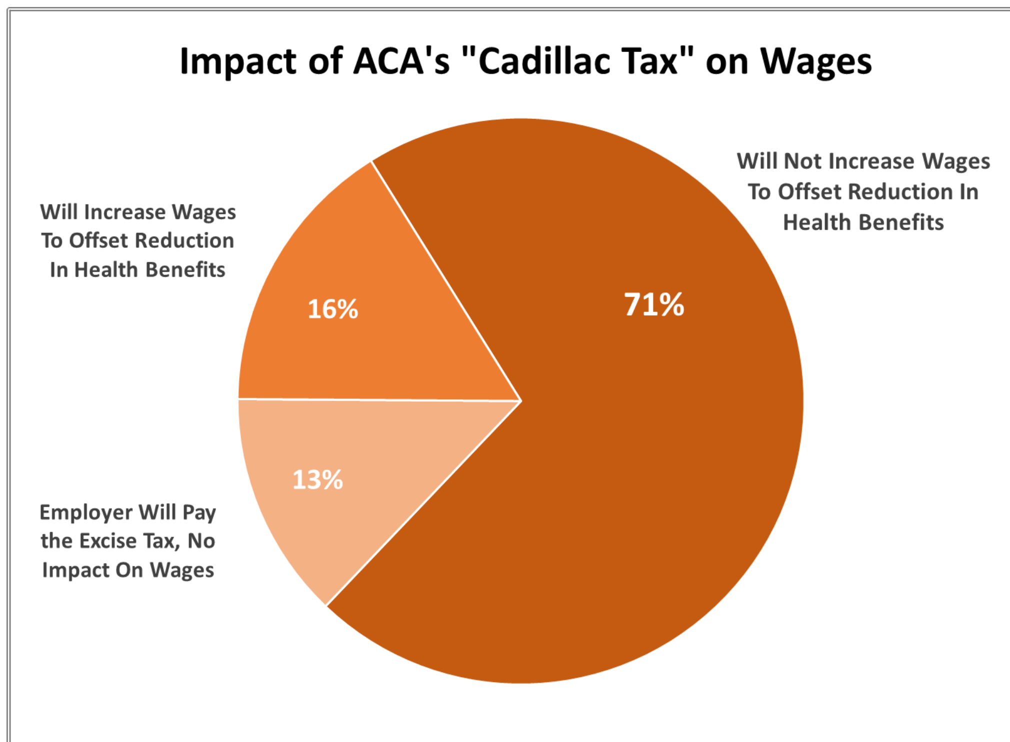
What Impact Will the Excise Tax Have On Wages?

The CBO and the JCT anticipate that as employers reduce the value of their health benefits they will increase wages and other forms of taxable compensation for employees: "Economic theory and evidence suggest that changes in the amounts spent by employers on untaxed fringe benefits—the largest of which is employment-based health insurance—are generally offset over time by changes in taxable wages and salaries, thereby keeping total compensation roughly unchanged."[16] Accordingly, CBO estimates that "roughly three-quarters" of the projected revenue from the excise tax will actually come from "the effects on revenues of changes in employees' taxable compensation and, to a lesser extent, in employers' deductible expenses."[17]

However, it is not clear how much employers will actually increase taxable wages as they reduce health care costs to avoid the excise tax. When the ACA was being debated in 2009, a Mercer survey of employers found that only 16 percent of respondents said they would convert their cost-savings into higher pay for workers.[18] While this might be an expected response from employers in the midst of the severest economic downturn in 30 years, the survey of employers conducted by the Institute in June 2015 found:

- 16 percent of large employers said they would increase wages to offset their reduction in health benefits as they seek to avoid triggering the excise tax;
- 13 percent said that they would pay the tax; and
- 71 percent said that they would probably not increase wages to offset their reduction in health benefits.

Over the past three years, productivity has been increasing at just 0.4 percent per year, while hourly compensation (wages and benefits) has been increasing 2.2 percent per year and consumer prices have been rising at an average rate of just 1.2 percent per year. Within this low productivity and low inflation economic environment, if health care cost increases remain relatively low, then taxable wages could rise in the long-run as the CBO and JCT predict. But wages are "sticky" in the short-run, and any wage increases may end up being invisible to employees whose higher wages will first be taxed, and then consumed by higher out-of-pocket health care costs that employees will have to bear.



How Much Revenue Will The Excise Tax Actually Generate?

The JCT currently estimates the excise tax will generate a total of $91 billion from 2018 to 2025,[19] with about 25 percent, or about $23 billion, coming directly from employers, third party administrators (TPAs), and insurance carriers, and 75 percent, or $68 billion, coming from increased income and payroll tax revenue paid by employees.[20] The current revenue estimate is significantly lower than CBO predicted as recently as January 2015 ($149 billion), and is likely to be further reduced if employer health care costs continue to moderate.

While it is not clear how much revenue the tax will actually generate over the next ten years, a number of other needed health care reforms could off-set most, if not all, of the revenue lost from repealing the tax. For example, enacting medical malpractice reform could save $57 billion over ten years,[21] and simply cutting the amount of improper Medicare payments by a third would save $25 billion per year.[22]

Conclusion

Congress clearly intended the ACA high-cost excise tax to reduce the value of employer provided health care benefits, and the provision is having the expected impact. The threat of the excise tax on high-cost health care plans after 2017 is driving employers to fundamentally reassess their plans and reconsider what their role and approach to providing health care benefits should be in the future. These reassessments will have a real impact on employees and their families. Cost sharing, benefit reduction, and other employer strategies to reduce their excise tax exposure threaten to make employer health plans unaffordable for many moderate to low wage employees and their families.

©2015 American Health Policy Institute

[1] This report is an update to the Institute's initial report on the excise tax publish in November 2014 and available at: http://www.americanhealthpolicy.org/Content/documents/resources/Excise_Tax_11102014.pdf.

[2] National Business Group on Health, 2016 Health Plan Design Survey, August 2015.

[3] Kaiser Family Foundation and the Health Research & Educational Trust, 2015 Employer Health Benefits Survey, September 2015, Exhibit 14.15.

[4] In 2018, the threshold amounts could receive a one-time upward adjustment to the extent the premium for the Federal Employees' Health Benefit Plan Blue Cross/Blue Shield standard benefit option (FEHBP option) increases by more than 55 percent between 2010 and 2018. For example, if the premium for FEHBP option coverage (holding benefits under the FEBHP option constant) increases by 57 percent from 2010 to 2017, the threshold amounts for 2018 will multiplied by 1.02 percent (57 percent minus 55 percent). However, to date (2014), the FEHBP option has increased by just 14.5 percent and is unlikely to exceed the 55 percent requirement by 2018.

[5] This question was asked of HR Policy Association members in September 2015.

[6] Mercer, National Survey of Employer-Sponsored Health Plans, December 2014, available at: http://ushealthnews.mercer.com/article/282/preparing-for-the-2018-excise-tax. Another survey by the Kaiser Family Foundation found between 18 and 24 percent of large employers (1,000 or more employees), estimate their *largest plan* will exceed the excise tax threshold in 2018. See Kaiser Family Foundation and the Health Research & Educational Trust, 2015 Employer Health Benefits Survey, September 2015, available at: http://kff.org/health-costs/report/2015-employer-health-benefits-survey/. The Kaiser results are likely lower than the Institute's survey because asking about the *largest plan* will typically focus on plans that are not subject to collective bargaining agreements since just 7.4 percent of private-sector employees were covered by a union contract in 2017. Focusing on non-collectively bargained plans that generally have less generous benefits and cost less will usually result in a lower percentage of plans saying they will hit the tax in 2018.

[7] National Business Group on Health, 2016 Health Plan Design Survey, August 2015. The NBGH results presented here are likely higher than the Institute's survey because most, if not all, employers who have a plan that will hit the tax in 2018 are taking steps to significantly reduce or eliminate their tax exposure.

[8] National Business Group on Health, 2016 Health Plan Design Survey, August 2015.

[9] Bureau of Labor Statistics, U.S. city average for medical care compared to all items less medical care.

[10] American Taxpayer Relief Act of 2012 amended the AMT to adjust the income threshold to inflation.

[11] Congressional Budget Offices, Selected CBO Publications Related to Health Care Legislation 2009-2010, December 2010, pg 218.

[12] Gary Claxton and Larry Levitt, How Many Employers Could be Affected by the Cadillac Plan Tax?, Kaiser Family Foundation, August 2015.

[13] National Business Group on Health, 2016 Health Plan Design Survey, August 2015.

[14] Kaiser Family Foundation and the Health Research & Educational Trust, 2015 Employer Health Benefits Survey, September 2015, Exhibit 14.15.

[15] Drew Altman, Why Higher Drug Costs Are Consumers' Biggest Cost Worry, The Wall Street Journal, September 8, 2015, available at: http://blogs.wsj.com/washwire/2015/09/08/why-higher-drug-costs-are-consumers-biggest-cost-worry/.

[16] Congressional Budget Office, Updated Budget Projections: 2015 to 2025, March 2015.

[17] Congressional Budget Office, Updated Estimates of the Effects of the Insurance Coverage Provisions of the Affordable Care Act, April 2014.

[18] Bob Herbert, "A Less Than Honest Policy," New York Times, December, 28, 2009.

[19] Joint Committee on Taxation, Estimated Revenue Effects of an Amendment in the Nature of a Substitute to the Budget Reconciliation Legislative Recommendations Relating to Repeal of Certain Excise Taxes Enacted in the Patient Protection and Affordable Care Act, JCT-130-15, September 28, 2015.

[20] Congressional Budget Office, Updated Estimates of the Effects of the Insurance Coverage Provisions of the Affordable Care Act, April 2014. Dollar estimates are Institute calculations.

[21] Congressional Budget Office, Health-Related Options for Reducing the Deficit: 2014 to 2023, December 2013.

[22] Government Accountability Office, Fiscal Outlook: Addressing Improper Payments and the Tax Gap Would Improve the Government's Fiscal Position, GAO-16-92T, October 1, 2015. Also see: Government Accountability Office, Medicare Program: Additional Actions Needed to Improve Eligibility Verification of Providers and Suppliers, GAO-15-448, June 2015.