

HEADS UP:

A Tax on Employee Benefits Is Coming Your Way

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The Affordable Care Act (ACA), enacted in 2010, includes a new excise tax on employee benefits set to go into effect on January 1, 2018. The 40 percent excise tax on the value of many employer-provided employee benefits plans above specific thresholds—nicknamed the “Cadillac tax”—was intended to be a backdoor way to limit the current tax incentive for these plans. Historically, economists have argued that overly generous employer health benefits raise the growth of health care spending by insulating consumers from the cost of health care services.

In reality, this tax likely will hit benefits plans covering a wide swath of American workers, increasing costs for employers and employees, reducing health care benefits for employees and causing a potential drag on U.S. jobs and economic growth. A new study from the NAM, *Heads Up: A Tax on Employee Benefits Is Coming Your Way*, takes a close look at the impacts of the tax and illustrates its economic effects under several scenarios for growth rates of plan premiums. However, premiums are only part of the taxable value of a benefits package. The ACA also contemplates the taxation of on-site medical clinics, on-site pharmacies, wellness programs, flexible spending accounts and health savings accounts. While these other components of health packages can be highly variable depending on the employer’s strategy, data limitations prevent a precise measure of their value, and therefore, they are not included in the analysis.

Under a scenario of relatively moderate growth in the cost of just the premiums for employer-provided health care (6 percent per year), there is a modest tax impact by 2025 and a significantly rising burden thereafter. In contrast, in the case of higher premium growth (8 percent per year, which was the norm until very recently), the tax snares a much larger proportion of benefit packages by 2025 and hits almost all plans by 2035.

The study finds that the employee benefits tax could have a large, negative impact on employee health benefits, jobs and the broader economy:

- Under the medium-growth scenario (6 percent), the tax would hit between almost 30 percent of manufacturers’ plans by 2025 and more than 80 percent by 2035. In the case of a high-growth rate (8 percent), the employee benefits tax would affect 60 percent of plans in the manufacturing sector by 2025 and virtually all plans by 2035.
- While some companies may be able to reduce benefits to avoid the tax temporarily, the study indicates that many companies with higher-cost benefits that would quickly be affected by the tax already have substantial deductibles and enrollee cost sharing, and those plans may not realistically be able to further reduce benefits to avoid the tax. Moreover, because the tax thresholds grow much more slowly than the likely growth of health premiums, virtually all employers would end up facing the tax at some point.
- In the high-growth scenario, the revenue generated by the tax would total more than \$670 billion by 2035—almost 1.5 percent of GDP. The economic tax burden would reduce GDP by 1.7 percent by 2035.
- Since this tax falls on labor, it would impact jobs and household income. In the high-growth case, assuming benefits were not cut, job losses from the tax could total 2.6 million by 2035, and real personal income in 2014 dollars would be reduced by almost \$3,800 per household.
- In all scenarios, the accelerating nature of the tax will eventually prompt many employers to continually increase cost sharing and/or eliminate benefits. The effect of including the value of other components of benefits packages, such as on-site clinics, on-site pharmacies, wellness programs, flexible spending accounts and health savings accounts, will be to place all of them in jeopardy in order to stay below an arbitrary cap.

Beginning in 2018, the tax will apply to the cost of benefits above \$10,200 for plans covering single employees and benefits above \$27,500 in family plans. While it was designed to hit so-called “high-value” plans, the excise tax will quickly spread to many “middle class” plans. This is because increases in the tax thresholds are based on the consumer price index (CPI), while the growth in health care expenditures, and therefore, premium costs, have historically outpaced general inflation. Over time, a very high proportion of premium levels will exceed the thresholds, subjecting more and more plans to the tax.

The analysis, conducted by Inforum for the NAM, compares the growth in the tax thresholds using estimates for the long-term growth of general inflation and three alternative scenarios for health insurance premium growth: low, medium and high. The medium-growth scenario assumes that health insurance premiums grow by 6 percent annually. The low-growth case assumes that premiums grow by 4 percent per year, while the high-growth scenario assumes growth of 8 percent per year.

Importantly, the low and high premium scenarios are neither unlikely nor extreme. According to the Kaiser Family Foundation (KFF) survey, from 1999 to 2015, premiums for employer plans have grown about 6.8 and 7.2 percent for single and family coverage, respectively. This history can be split between two intervals. From 1999 through 2007, average single premiums rose by 9.4 percent per year, and family premiums grew by an even greater 9.7 percent per year. On the other hand, since 2008, premium growth has averaged 4.3 and 4.8 percent for single and family coverage, respectively.

Impact on Manufacturers

The charts that follow illustrate how the tax would affect manufacturing health care plans over time. The inverted S-curves in Figure 1 represent the distribution of premium levels across manufacturers’ benefit plans in the year indicated.¹ The flat lines are the tax thresholds for each year. For the single and family plans, the blue lines represent the premiums and thresholds for 2025, seven years after the tax goes into effect. The red lines refer to 2035. Under the medium scenario, premiums grow by 6.0 percent per year beginning in 2016. As time goes by, health premiums increase faster than the thresholds, which generally grow at the projected rate of the CPI (2.4 percent), so the tax affects an increasing proportion of health care plans.

Figure 1: Single and Family Premiums in the Manufacturing Industry Compared to the Excise Tax Thresholds Under the Medium-Growth Scenario (6%)

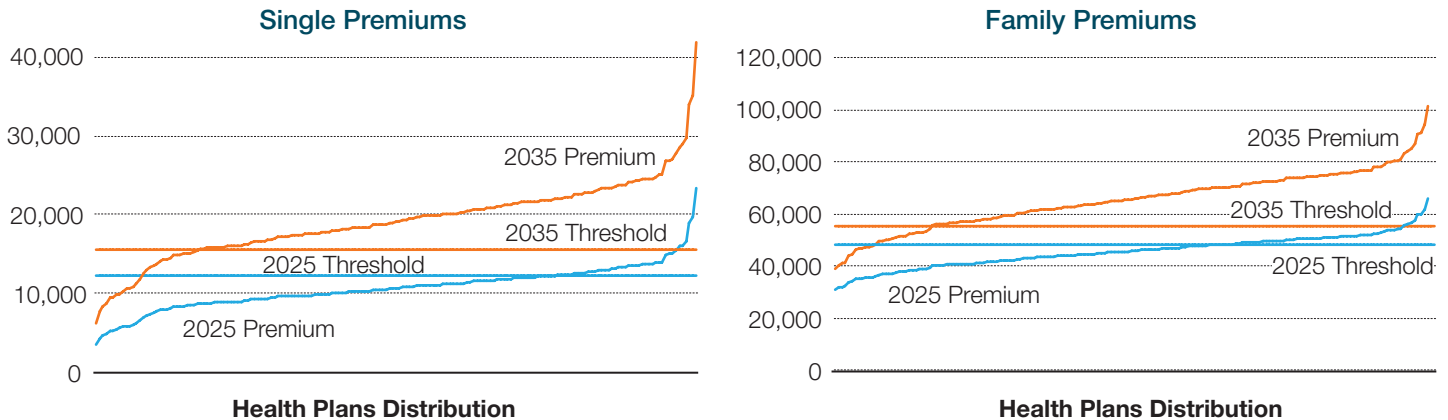
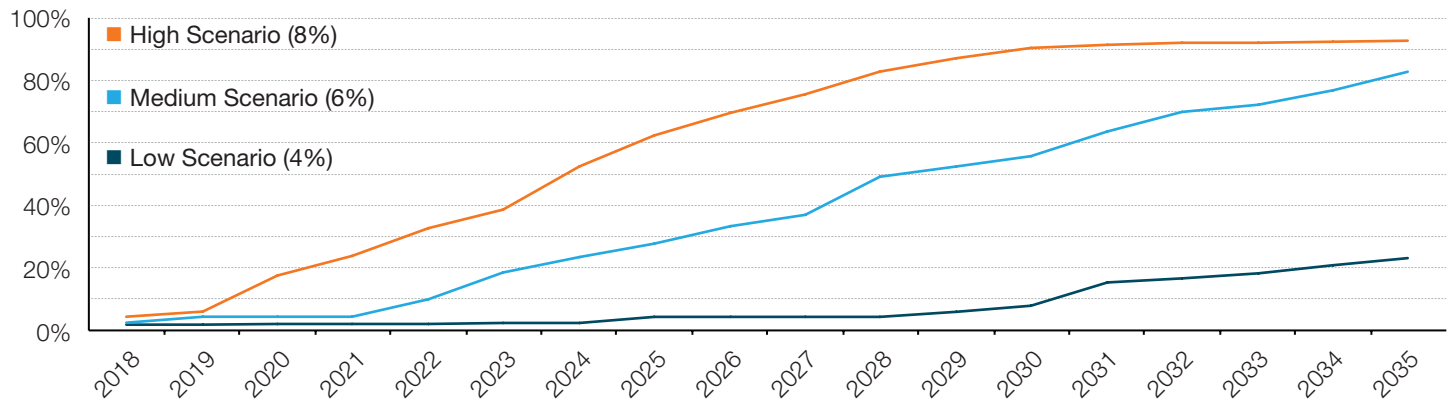


Figure 2 illustrates the proportion of manufacturing employees’ plans the tax would affect from 2018 through 2035 for each scenario. In the medium-growth scenario, 28 percent of health plans will be subject to the tax by 2025. By 2035, that proportion rises to 83 percent. In the high-growth scenario, the proportion of plans subject to the tax in the manufacturing sector exceeds 60 percent by 2025 and 90 percent by 2035. Again, these calculations are based on the premiums alone, not the full complement of benefits (contributions to health savings accounts and flexible spending accounts, on-site clinics and so on) that would be subject to the tax threshold. A full accounting for the value of these other benefits would push more plans over the edge.

¹ The premium data is from the KFF survey of employer health benefits in 2014.

Figure 2: Percentage of Manufacturing Employees Affected, Low-, Medium- and High-Growth Scenarios



Economic Impact

Part two of the analysis uses the Inforum LIFT interindustry macroeconomic model to estimate the industrial and macroeconomic impacts of the employee benefits tax for each of the three scenarios described above.

Table 1 shows that under the medium-growth scenario (6 percent), the excise tax would cost employers \$31.8 billion by 2025 and \$243.6 billion by 2035, more than 0.5 percent of GDP. Under the high-growth scenario (8 percent), revenue collections would increase to nearly \$673 billion by 2035—almost 1.5 percent of GDP.

To measure the economic impact, these projections were inputted into the LIFT model, and the simulation results were compared to a baseline without the tax. The results of this analysis are displayed in Table 1. Under each scenario, real GDP, consumption, investment and exports are all reduced proportionately to the size of the tax increases.

Table 1: Macroeconomic Effects of Employee Benefits Tax, 2018–2035

(All Figures Are Difference from No Tax Baseline Scenario as Indicated)

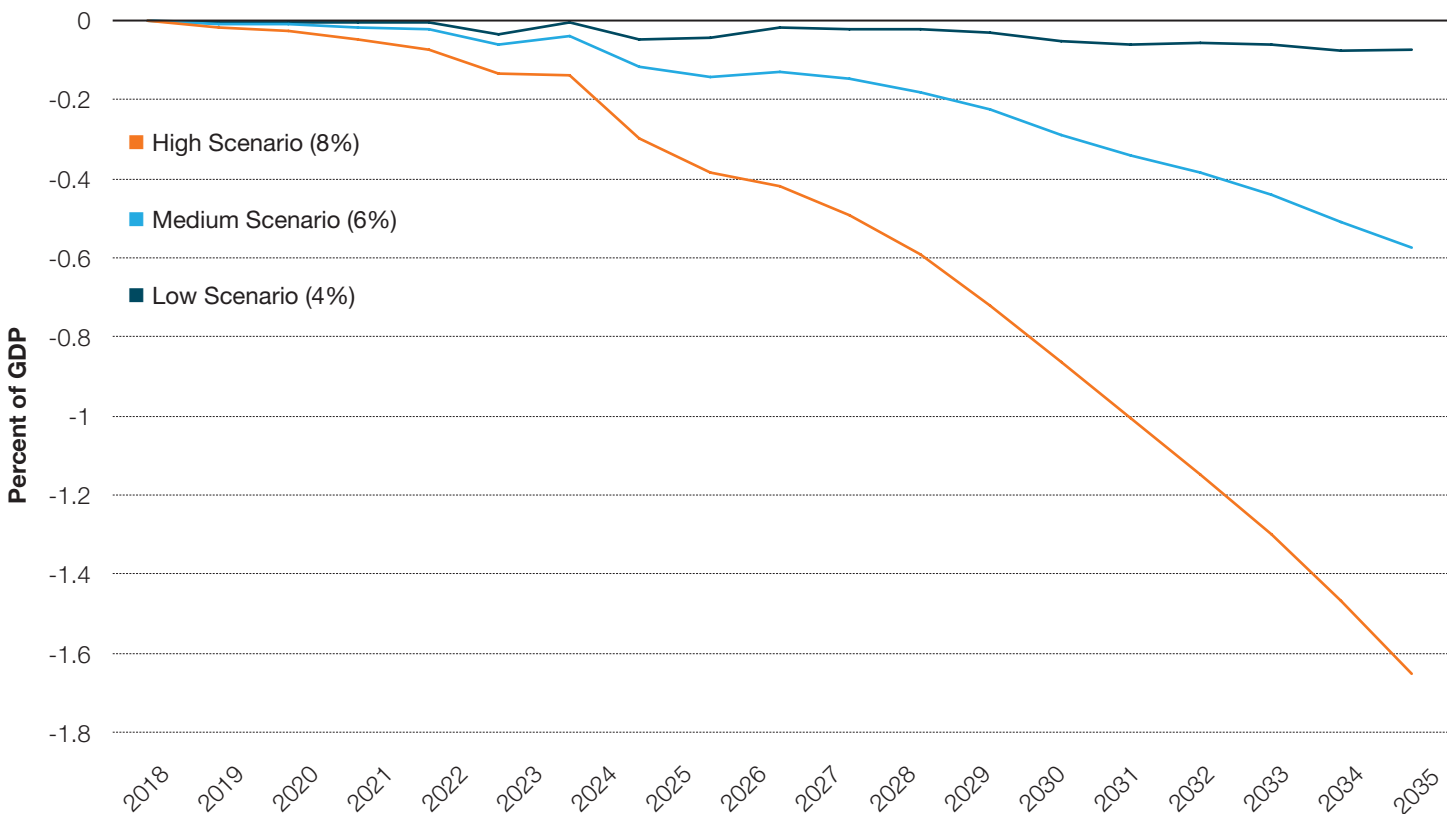
	Premium Growth	2018	2020	2025	2030	2035
Total Employee Benefits Tax						
Billions of dollars	Low	2.8	3.4	7.6	17.2	35.7
	Medium	4.5	7.6	31.8	100.6	243.6
	High	7.3	15.7	90.8	294.7	672.9
As percent of nominal GDP	Low	0.01	0.01	0.03	0.05	0.08
	Medium	0.02	0.03	0.11	0.28	0.54
	High	0.03	0.07	0.31	0.81	1.48
Real Gross Domestic Product						
Difference in billions 2014 dollars	Low	-1.3	-0.7	-10.4	-13.7	-21.8
	Medium	-1.4	-3.3	-33.3	-74.5	-165.6
	High	-3.2	-9.4	-88.9	-222.7	-476.2
Percent difference	Low	-0.01	0.00	-0.05	-0.05	-0.08
	Medium	-0.01	-0.02	-0.14	-0.29	-0.57
	High	-0.02	-0.05	-0.39	-0.86	-1.65
Total Employment						
Thousands of jobs	Low	-6	-5	-80	-75	-129
	Medium	-7	-21	-225	-436	-917
	High	-16	-60	-582	-1325	-2629
Income Per Household						
Difference in dollars 2014 dollars	Low	-22	-23	-86	-110	-181
	Medium	-29	-50	-271	-608	-1305
	High	-47	-109	-722	-1837	-3758

Source: Inforum

The top of Table 1 shows the total costs of the employee benefits tax. As explained earlier, because the tax thresholds rise with general inflation and don't reflect the actual increase of health care premiums, the tax burden rises exponentially, both in absolute terms and relative to GDP. Table 1 shows that the acceleration of tax collections results in a similar acceleration of the reduction of real (inflation adjusted) GDP. In the medium-growth case, real GDP is reduced by \$33.3 billion (2014 dollars) by 2025 and \$165.6 billion by 2035. If premiums grow at 8 percent, the loss of real GDP is almost \$90 billion (in 2014 dollars) by 2025 and more than \$476 billion by 2035. Figure 3 displays the impact on GDP in percentage terms, and it clearly shows the exponential impact of the tax. In the high-growth case, the decrease in real GDP is felt almost immediately and exceeds 1.6 percent by 2035.

Because the employee benefits tax ultimately falls on labor, it has a negative impact both on employment and real household income. Employment losses by 2035 reach 129,000 jobs in the low-growth case, 917,000 in the medium-growth scenario and 2,629,000 in the high-growth case. In the high-growth scenario, household income falls by 2.14 percent in 2035, in contrast to a real GDP loss of just 1.65 percent. This is equivalent to almost \$3,758 per household in 2014 dollars. The macroeconomic modeling results illustrate how the tax could produce large and unintended damage if premiums rise at the rate seen earlier in the century.

Figure 3: Reduction of GDP Due to Employee Benefits Tax



While there may be valid reasons to change the tax treatment of employee-provided health benefits, the employee benefits tax is highly sensitive to the rate of premium growth, and it is important to look at the impact of the tax under a range of premium projections. The tax creates substantial confusion and uncertainty, will trigger disruptive adjustments to health plans and likely will become a heavier burden on workers. Moreover, the design of the excise tax means that its negative impacts on economic activity and job creation could escalate over time. In its current form, the employee benefits tax adds much more complexity to an already uncertain health care system.

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