

ALLIANCE TO FIGHT THE 40

Stop the 40% tax on health benefits

DISPELLING THE MYTH THAT WORKERS WILL GET A 'RAISE' FROM THE CADILLAC TAX

The Obama Administration and supporters of the 40% “Cadillac Tax” on health benefits claim that it will lead to higher pay for workers, hypothesizing that as employers cut back on health care benefits they will commensurately increase workers’ take-home pay. Their argument suggests that workers would somehow be better off after the imposition of new taxes. Here is what Administration officials have said:

“If we implement the Cadillac tax, we’re going to see upward pressure on raises.”
- White House Press Secretary Josh Earnest, Feb. 5, 2016

“Economic theory and empirical evidence suggest that the money employers will save on health benefits because of the tax will, in the long run, benefit workers by allowing for higher wages.”
- Council of Economic Advisers Chairman Jason Furman, Feb. 3, 2016

The Cadillac tax will not give workers a “raise.” Employees will lose money and the middle class will be the hardest hit. Here is why:

Employers are already reluctantly scaling back their health plans. To stay below the thresholds and avoid the tax, employers are raising deductibles and copays, increasing employees’ out-of-pocket health care costs. Meanwhile, health care costs continue to increase much faster than wages. **According to the Kaiser Family Foundation, over the past five years, employees’ share of deductibles grew nearly six times faster than wages. At the same time, premiums increased by 19%.¹** Any hypothetical wage gains are likely to be consumed by growing health care costs.

There is no credible body of research providing evidence of commensurate wage increases when benefit costs are reduced. Rather, the studies in support of compensating wage adjustments observed *gradual reductions in wages* following employee benefit cost increases.² Therefore, not only is there a lack of real-world evidence backing the Administration’s claim, but economic theory suggests that wage adjustments may take as long as a decade to unfold, leaving workers with years of uncompensated benefit cuts. The current labor market shows no indication of impending rapid wage growth for moderate income groups. And if wage adjustments are made, they will not be made for every employee. In these circumstances, higher-wage workers have greater leverage and would be expected to benefit, while middle-class workers may be left behind.

It is for good reason that American voters do not buy the argument that reduced health benefits will be matched by wage increases.³

¹ Kaiser Family Foundation and Health Research and Educational Trust (HRET) 2016 Employer Health Benefits Survey, September 2016, accessed [here](#).

² Lubotsky, Darren, “The Economics of Employee Benefits,” Department of Economics and Institute of Labor and Industrial Relations, University of Illinois at Urbana Champaign, August 2004, accessed [here](#).

³ Poll of voters dismissed arguments that workers should expect wage increases from implementation of the tax. American Benefits Council, “Key Findings from Nationwide Public Opinion Survey on 40 Percent ‘Cadillac Tax’” March 2016, accessed [here](#).

Employees' post-tax compensation will be lower under the Cadillac Tax even if employers increase wages to compensate for benefit cuts.

Finally, even if the Administration's argument became reality and an employee eventually received a dollar-for-dollar wage adjustment to offset benefit cuts, that worker would still be financially worse off. Due to the employee paying payroll and income taxes on the cash compensation, the employee will have less money to pay the higher out-of-pocket costs for their health care.^{4,5}

The following example illustrates the net financial effects of how moderate wage workers will be worse off after the "Cadillac Tax" even if they experience an increase in wages.

Let's say an employer increased the deductible in its health plan by \$1000 and is able to reduce the overall premium by \$500 to remain under the "Cadillac Tax" thresholds.⁶ The employee's out-of-pocket costs are now \$1000 higher for the same health care services. But, let's further assume the employer uses the \$500 it saved in health plan costs to provide a \$500 increase in employee wages. Even if the employer shifts all savings to the employee, the employee still does not break even. Unfortunately, her \$500 wage increase is now subject to payroll and income taxes, and the additional \$1000 in out-of-pocket health care costs will have to be paid with after-tax dollars. **As a result, the employee is financially worse off. A worker in the 15% marginal federal tax bracket (earning between \$9,276 and \$37,650 annually in 2016) would experience a loss of about -\$651 to access the same health care after the Cadillac tax driven benefit cuts.** This is because any wage increase would, in addition to federal income tax, be subject to a 15.3% payroll tax rate. Although not included in the example, the increased wages may also be subject to state and local income taxes in most circumstances.

Out-of-pocket cost increase		- \$ 1000
Wage increase		\$ 500
(Less) Income tax and payroll tax change	$\$500 \times 30.3\% =$	- \$ 151.50
Net cost to worker due to the "Cadillac Tax"		- \$ 651.50

Your health care dollar before the 40% tax on health benefits:



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This direct financial cost is regrettably only one part of the inequitable burden that will be imposed on working Americans by the "Cadillac Tax." Faced with higher out-of-pocket costs, families with modest incomes may forgo needed health care causing long-term health consequences. While those in higher tax brackets will experience steeper financial consequences, they may be better able to adjust to the higher cost of health care. It will be lower- and moderate-income workers who could pay with both their money and their health.

If we wait, it will be too late.
Repeal the "Cadillac Tax" now.

The Alliance to Fight the 40 is a broad based coalition comprised of patient advocates, businesses, consumer and employer organizations and other stakeholders that support employer-sponsored health coverage. This coverage protects over 175 million Americans across the United States. The Alliance seeks to repeal the 40% tax on employee health benefits to ensure that employer-sponsored coverage remains an effective and affordable option for working Americans and their families.

⁴ USA Today, "Businesses say feds wrong to assume wages will rise as benefits shrink," November 2016, accessed [here](#).

⁵ Beezley-Smith, Dana, "Questioning Jonathan Gruber's 'Wage Growth' Promises," Fall 2015, accessed [here](#).

⁶ Estimated required deductible increase to decrease premiums by \$500, would be approximately \$1000 according to economic and actuarial estimates by the Blue Cross Blue Shield Association.