Planning for the Cadillac Tax (Section 4980I)

Presented by

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Section 4980I: Brief Summary

- 40% Nondeductible excise tax on the "aggregate cost" of health coverage that exceeds set annual limits (the "excess benefit")
- Applies to plans offered by taxable and non-taxable entities, governmental plans, church plans
- Applies to grandfathered and non-grandfathered plans
- Effective 2018

IRS Guidance

- No proposed regulations yet
- IRS Notice 2015-16 (comment period closed May 15, 2015)
- IRS Notice 2015-52 (comment period closed October 1, 2015)
- Many open questions

Coverage Subject to the Tax

Coverage under a group health plan, made available to an employee by an employer, regardless of whether coverage is paid for by employer or employee

- "Employee" includes current employees, and:
  - Retirees
  - Surviving spouses
  - Certain expatriates assigned to work in the U.S.
  - Self-employed individuals if all or a portion of the cost can be deducted under Code § 162(l)

Coverage Subject to the Tax

- Major medical (including retiree plans and multiemployer plans)
- Health FSAs
- HSAs and Archer MSAs (employer contributions or employee pre-tax contributions)
- HRAs
- Executive physical programs
- Specified disease/fixed indemnity plans paid by employer or with pre-tax salary reductions

Coverage Not Subject to the Tax

- Accident or disability income
- Liability coverage, supplemental liability coverage
- Automobile medical-payment insurance
- Credit-only insurance
- Long term care coverage
- Employees' post-tax HSA contributions
- Workers' compensation coverage
- Specified disease/fixed indemnity coverage paid with after-tax dollars

Coverage That May Be Subject to the Tax

- Limited scope dental and vision
  - Statutory language suggests that only <u>insured</u> limited scope dental and vision are excluded
  - Probable IRS approach: if coverage qualifies as an excepted benefit, it is excluded regardless of insured or self-insured
- On-site Medical Clinics
  - Excluded if only de minimis medical care provided
  - Comments requested

Coverage That May Be Subject to the Tax

- Employee Assistance Programs (EAPs)
  - IRS considering an approach that if coverage qualifies as an excepted benefit, it is excluded
- Wellness programs that are standalone group health plans
  - Not specifically addressed

Who is Liable for the Tax?

The "coverage provider"

- Insured Plans: Insurance carrier
- HSA or Archer MSA contributions: Employer
- Other coverage: "Person that administers the plan benefits"
  - The entity actually performing administrative functions? (i.e., third party administrator) or
  - The entity that has ultimate authority over plan administration? (i.e., ERISA plan administrator or plan sponsor)

Annual Dollar Limits

- Self-only ($10,200)
- Other than self-only ($27,500)
  - Multiemployer coverage always other than self-only
- Includes both employer and employee share of cost
- Determined by coverage employee has at beginning of month
- What if employee has both self-only and other than self-only coverage?

Annual Dollar Limit Adjustments

Adjustments

- Health cost adjustment percentage (2018 only)
- Cost-of-living adjustment (years after 2018)
- Age and gender if different than national risk pool
- Qualified retirees (receiving retiree coverage, age 55+, not eligible for Medicare)
  - $11,850 for self-only
  - $30,950 for other than self-only
- High risk professions (law enforcement, fire, paramedics, longshore work, construction, mining, agriculture [not food processing], forestry, fishing, repair and installation of electrical or telecommunications lines, retirees if 20 years in high risk profession)

Determining the cost of coverage

Determined using rules "similar to" rules for determining COBRA premium (average cost of providing coverage to "similarly situated" individuals under the plan)

- <u>Not</u> the same as determining cost of coverage for Form W-2 reporting
- Cadillac tax due not included
- Insured Plan: premium charged for active employees
  - Cadillac tax due should be separately billed
- Self-Insured Plan:
  - Actuarial basis method: cost for similarly situated beneficiaries determined on an actuarial basis
  - Past cost method: cost for similarly situated beneficiaries in prior 12-month period, adjusted by implicit price deflator

Determining the cost of coverage

- HRAs: COBRA premium determination is unclear
- HSAs: employer contributions + salary reductions
- Health FSAs: the greater of the amount of salary reductions or the total reimbursements
  - Unclear how carryovers handled

Who Calculates the Tax?

- Taxable period: calendar year
- Employer is responsible for calculating the cost of coverage provided to an employee each month (*multiemployer plans?*)
- Must allocate the tax to each coverage provider
- Notify IRS and the coverage provider of the amount of the excess benefit

Calculating the Tax

- Determine aggregate cost of coverage for each month in the calendar year
- Determine the "excess benefit" for each month (total aggregate cost minus 1/12th of applicable dollar limit)
- Add the total excess benefit for each month
- Multiply the excess benefit by 40%

How is the Tax Paid?

- Form 720, Quarterly Federal Excise Tax Return
- Can the tax be paid from plan assets?

Why???

- Raise revenue to fund other provisions of the Affordable Care Act
- Control health care costs by reducing demand for reducing demand for high-cost coverage

Anticipated Impacts

Revenue:

- $87 billion over the first eight years
- Previous estimates were $120 billion over the first seven years
- Premium growth now projected to be slower and fewer workers expected to enroll in employer-sponsored coverage

Oregon:

- 6.7% of employer-sponsored single premiums estimated to exceed Cadillac Tax threshold in 2018
- 5% of employer-sponsored non-single premiums estimated to exceed Cadillac Tax threshold in 2018

Source: "*The Excise Tax on High-Cost Employer-Sponsored Health Coverage: Background and Economic Analysis*," Sean Lowry, Congressional Research Service, August 20, 2015

Anticipated Impacts

"Absent significant changes in the trajectory of insurance premium costs or types of health plans offered by employers, the Cadillac tax is expected to apply to a greater share of employer-sponsored health plans over time. Changes in the trajectory of premium costs primarily affect when, not if, the Cadillac tax will apply to most health plans as they are structured today." (*CRS Report*, August 20, 2015)

- Some employers may eliminate high-cost health plans to avoid the tax and offset with increased taxable wages.
- Others may keep their high-cost plans, pay the tax, and compensate by lowering wages.

Questions?

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