Bumps in the Road to Implementing the Cadillac Tax
Issues, Solutions and Unresolved Questions
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Statutory Provisions
26 U.S.C. § 4980I
- 40% tax on “excess benefit” provided to “employee” under “applicable employer-sponsored coverage”
- Starting in 2018

Applicable Employer-Sponsored Coverage
Coverage under any group health plan:
- made available to an employee
- by an employer
- which is excludable from the employee’s gross income under section 106, or would be so excludable if it were employer-provided coverage

Includes:
- Employee paid portion and employer paid portion
- Self-employed individual coverage that is deductible under Section 162(f)
- Governmental plans (but Notice 2015-16 excludes military coverage)
- Self insured and fully insured coverage
Applicable Employer-Sponsored Coverage
Includes:
- Health FSAs
- Archer MSAs and HSAs (but Notice 2015-16 excludes after-tax employee contributions to HSAs)
- On-site medical clinics (but final regulations will likely exclude de minimis coverage)
- Retiree medical plans
- Multiemployer plans
- Coverage for specified diseases or illness (if excluded from gross income)
- Expect final regulations to clarify that executive physical programs and Health Reimbursement Arrangements (HRAs) are applicable coverage

Applicable Employer-Sponsored Coverage
Excludes:
- HIPAA excepted benefits
  - Accident and disability income insurance
  - Supplemental liability coverage
  - Workers comp
  - Auto medical liability insurance
  - Final regulations also expected to exclude EAPs that meet regulatory exception to HIPAA
- Long term care coverage
- Dental and eye coverage, if provided under a separate insurance policy (but final regulations expected to exclude self-insured limited scope dental and vision coverage as well)
- Coverage for specified diseases or illness (if included in gross income)

Employee
- Current employee
- Former employee
- Surviving spouse
- "Other primary insured individual"

Employer
- Code Section 414 control group and affiliated service group rules apply
Excess Benefit

- Aggregate cost of employer-sponsored coverage (actually provided, not just offered) in excess of:
  - $10,200 for self-only coverage
  - $27,500 for anything other than self-only coverage
- Base 2018 amounts subject to “health cost adjustment” based on:
  - Whether cost of Blue Cross/Blue Shield standard benefit option under the Federal Employees Health Benefits Plan for plan year 2018 is more than 155% of the 2010 cost
- Base 2018 amounts also subject to adjustment for:
  - Retirees and
  - Participants in plans primarily covering employees “engaged in a high-risk profession or employed to repair or install electrical or telecommunications lines”
  - Limits increased by $1,650 for self-only coverage and $3,450 for other coverage

Limits also adjusted in all years for age and gender characteristics of the employer’s workforce
- Based on cost of Blue Cross/Blue Shield standard benefit option under the Federal Employees Health Benefits Plan, if it were priced for the age and gender characteristics of the employer’s plan, as compared to the cost as priced for the national workforce.
- Limits also adjusted in years after 2018 based on:
  - COLA (based on CPI in Code Section 1(f)(3) (plus 1% for 2019 only)

Tax is determined monthly (i.e. monthly excess benefit is 1/12 of the above amounts)

Determining “Cost”

Generally, “cost” is determined using rules “similar” to COBRA rules

For Health FSAs, cost is:
- Salary reduction contributions, plus
- Any reimbursements in excess of salary reduction contributions (i.e. reimbursements under the FSA based on ER contributions)

For Archer MSAs and HSAs:
- Employer contributions

“Cost” does not include any amount attributable to the Cadillac tax
Who Pays the Tax?

Each “coverage provider” pays the tax with respect to “its applicable share” of the excess benefit:
- For an insured group health plan = the health insurer
- For HSA and MSA contributions = the employer
- For other coverage = the person that administers the benefits
  - includes the plan sponsor if the plan sponsor administers benefits under the plan

Employer does the calculations and notifies other coverage providers of their share

The tax is not deductible

Penalties for Failure To Pay Sufficient Tax

If tax calculated by employer is short:
- Each coverage provider still has to pay its share of the tax due, without penalty
- In addition, employer has to pay a penalty equal to total shortfall, plus interest

Penalty not imposed if:
- Employer neither know, nor exercising reasonable diligence would have known, of the failure
- Failure was due to reasonable cause and is corrected within 30 days after employer know or reasonably should have known of the failure
- Failure due to reasonable cause and waived by Secretary because penalty would be excessive or inequitable relative to the failure

How Broadly Will the Tax Apply?

One study by the Kaiser Family Foundation estimates that for plans that do not include an FSA component (and don’t make any design changes):
- 16% of employers who offer health benefits will be subject to the tax in 2018,
  - increases to 22% in 2023 and
  - 38% in 2028

For plans with FSAs the number of employers affected by the tax rises to:
- 26% in 2018
- 30% in 2023, and
- 42% in 2028
Regulations and Guidance

IRS Notice 2015-16 addresses:
- the coverage to which the tax applies,
- determining the cost of applicable coverage, and
- applying the annual statutory dollar limit to the cost of applicable coverage.

IRS Notice 2015-52 addresses:
- the identification of the taxpayers who may be liable for the excise tax,
- employer aggregation,
- allocation of the tax among the applicable taxpayers,
- payment of the applicable tax.
- further issues regarding the cost of applicable coverage that were not addressed in Notice 2015-16.

Unresolved Issues

Cost of Coverage
- COBRA has two ways to determine cost:
  - Actuarial basis
  - Past cost (unless there has been a significant change in coverage)
- Treasury and IRS
  - expect to permit both methods self insured plans for purposes of 4980I
  - considering requiring use of the same method for five years.
Unresolved Issues

Cost of Coverage
- COBRA cost = cost for “similarly situated” non-COBRA beneficiaries
  - the covered employees, spouses of covered employees, or dependent children of covered employees receiving coverage who are most similarly situated to the situation of the qualified beneficiary immediately before the qualifying event
- Expect final regulations to provide each group of similarly situated employees would be determined by aggregating all employees covered by a particular benefit package, then subdividing that group based on mandatory disaggregation rules, and allowing further subdivision of the group based on permissive disaggregation rules.

Unresolved Issues

Aggregation by benefit package
- Based on differences in coverage actually enrolled in
  - high v. low option
  - PPO v HMO
  - HDHP v standard deductibles

Mandatory Disaggregation
- Self only v other than self only

Unresolved Issues

Permissive Aggregation within other than self-only coverage. IRS and Treasury considering rules that determine other than self only coverage cost without regard to the number of people covered (self +1 or self +2 or family)
- This is consistent with 4980(d)(2)(A), which does not require cost of coverage consider the number of others covered, but is not consistent with COBRA.
Unresolved Issues

Permissive Disaggregation. IRS and Treasury considering whether to allow (but not require) disaggregation based on criteria traditionally applied in the group insurance market, including:

- A broad standard permitting disaggregation based on bona fide employment-related criteria such as:
  - nature of compensation,
  - specified job categories,
  - collective bargaining status, etc.
- A specific standard based on specified criteria such as:
  - Current and former employees
  - Bona fide geographic locations (metro vs. rural, business locations, states of residence...)
  - Number of people covered under other than self only coverage

Unresolved Issues

Valuing HRA coverage. Treasury and IRS considering a number of approaches:

- Amounts made newly available to a participant each year, and/or
- Add all claims and administrative expenses attributable to HRAs for a particular period (separately for each level of coverage if the employer allocation differs by employee election, and dividing that sum by the number of employees covered for that period (at that level of coverage); and/or
- Actuarial basis method

Unresolved Issues

Both self only and other than self only coverage. Example: Self only major medical + Family HRA coverage. IRS and Treasury considering two approaches:

- Apply the limit of the primary coverage (most valuable)
  - Self-only = $3,000 and OTSO = $9,000 - apply the OTSO limit to the full $12,000
- Apply a composite limit
  - 25% of the self only limit ($3,000/$12,000); plus 75% of the OTSO limit
Unresolved Issues

"Person That Administers the Plan Benefits" is not defined or used elsewhere in the Code, ERISA or the ACA. IRS and Treasury considering two approaches

- The person responsible for day-to-day administration of plan benefits, such as
  - receiving and processing claims for benefits,
  - responding to inquiries, or
  - providing a technology platform for benefits information
- The person that has the ultimate authority for administration of the plan benefits, including final decisions on administrative matters, even if they don’t routinely exercise the authority, over matters such as
  - eligibility determinations,
  - claims administration, and
  - arrangements with service providers

Unresolved Issues

Control Group/Employer Aggregation. Treasury and IRS are considering how the control group rules impact the identification of:

- the applicable coverage taken into account as made available by an employer (§ 4980I(d)(1)(A));
- the employees taken into account for the age and gender adjustment, and the adjustment for employees in high risk professions;
- the taxpayer responsible for calculating and reporting the excess benefit; and
- the employer liable for any penalty for failure to properly calculate the tax imposed under § 4980I

Unresolved Issues

Timing of cost of coverage determinations

- End the measurement period for self insured plans to leave sufficient time to calculate and allocate the tax
- What about experience-rated payments from insurance company
  - Refund v. discount for next year

Exclusion of Cadillac Tax from Cost of Coverage

- Insurers and 3rd party administrators will pass tax on (or back) to the employer
- Reimbursement of the tax will be taxable income to the 3rd party (including any tax gross up), because the tax is not deductible
- Cost of coverage excludes the tax. What about the gross-up?
Unresolved Issues
Allocation of Contributions to HSAs, MSAs, FSAs and HRAs

- Allocate pro rata to the months in the Plan year or calendar year, regardless of when actually made?

Questions

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