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legislativeUPDATE

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Cadillac Tax Guidance Has Begun

January 1, 2018 marks the effective date of the excise tax on high cost employer-sponsored health coverage, popularly known as the "Cadillac Tax". Imposed under Internal Revenue Code (IRC) section 4980I as required by healthcare reform, there has generally been a lack of regulatory guidance regarding this tax, which has left many unanswered questions stemming from seemingly ambiguous and limited information.

Recently issued Notice 2015-16, the first notice solely addressing the tax, is the initial guidance issued by the Treasury Department and the IRS (the "agencies") to clarify some of the issues related to the tax. This guidance has been explained as the first of many efforts by the agencies to provide the information needed to assist with compliance. The notice is a precursor to additional forthcoming guidance and it is expected that another agency notice providing additional clarifications and requests for comments will follow. These notices should be followed by proposed regulations and then final regulations should be released prior to the 2018 effective date. This update is intended to provide a high level overview of some of the items addressed in Notice 2015-16.

General Background

The Cadillac Tax imposes a 40% non-deductible tax on the excess amount of the aggregate cost of "applicable employer–sponsored coverage" in a calendar year. Applicable employer–sponsored coverage is generally defined as the coverage under any group health plan made available to employees by an employer which is excludable from the employee's gross income or would be excludable from the employee's gross income under IRC section 106. The definition of "employees" includes former employees, retirees, surviving spouses and "other primary insureds" (an undefined term). The tax applies to all employers subject to excise tax provisions of the IRC which includes all private employers, regardless of size, and also includes tax exempt and governmental entities. The excess amount of the total cost of coverage, from which the tax is calculated, is the amount of applicable coverage which exceeds the annual statutory limits, which have been set at $10,200 for individual coverage and $27,500 for other-than-individual coverage for the 2018 tax year.

The tax is calculated on a monthly basis, but is assessed on a calendar year basis. The value of applicable coverage must be calculated based on approved methods identified in the guidance and the rules permit adjustments to the limits for retirees and high risk professions, as well as age and gender adjustments. Adjustments will also be made through 2018 and beyond for health cost inflation.

Each provider of coverage is responsible for paying its share of the tax. For all fully-insured coverages, the health insurer is the coverage provider. For self-insured coverages or other coverage, the employer/plan administrator is responsible for paying the tax. Keep in mind that while the coverage provider is responsible for paying the tax, employers sponsoring health plans are responsible for calculating the tax and determining the share of the tax attributable to each coverage provider. In general, penalties may be assessed on employers who miscalculate the tax or fail to correctly attribute the tax to the responsible party. The employer may be responsible for a penalty equal to 100% of the error plus interest. The IRS reserves the right to waive penalties for employers who can prove they were not aware of the mistake provided the mistake is corrected timely, within 30 days.

Key Issues of Notice 2015-16

Notice 2015-16 provides clarification on some of the complexities surrounding the tax and also serves as the initial opportunity for the agencies to accept comments on many areas where guidance is still needed. Notice 2015-16 provides guidance on the following issues:

Definition of Applicable Coverage.

The Cadillac Tax is calculated based on the applicable coverage the employee is enrolled in, not based on the coverage offered to an employee. Applicable coverage includes major medical health coverage, prescription drug coverage, retiree health plans, and other coverages. There are also a number of coverages excluded from the definition of applicable coverage, such as long term care benefits, liability insurance, accident and disability coverages, and others.

Notice 2015-16 provides a list of coverages excluded from the definition of applicable coverage and also describes the list of coverages included in this definition. It is confirmed in the Notice that applicable coverage includes both employer paid and employee paid (with after-tax dollars) coverages. The guidance reiterates that health FSAs, government plans, retiree coverage, multiemployer plans, and coverage for specified disease or illness, hospital indemnity or other fixed indemnity coverage (if the coverage is excluded from gross income or deducted under IRC section 162(I)) are considered applicable coverage subject to the tax.

In Notice 2016-15, the agencies also provide that they **anticipate** future Cadillac Tax guidance will reflect the following:

- **HSAs/Archer MSAs –** Employer contributions, including employee salary reductions to HSAs, are included in the definition of applicable coverage. Employee after-tax contributions to an HSA are not included in the definition of applicable coverage.
- **On Site Medical Clinics –** Applicable coverage does not include onsite medical clinics that offer de minimis medical care. The COBRA regulations regarding onsite clinics that are not considered group health plans are cited, which generally provide that if the healthcare is provided during the employer's work hours for the treatment of an injury, illness or health condition that occurs during work hours and the healthcare is only provided to current employees at no charge to the employees, then the onsite medical clinic is not subject to COBRA. Similar rules will likely determine whether on-site medical clinics are exempt from the definition of applicable coverage.
- **Limited Scope Dental and Vision Benefits –** While it was clear that fully insured limited scope dental and vision coverages were excluded from the definition of applicable coverage, before the recent guidance, there was no conclusive information on whether this exception included self-insured HIPAA excepted vision and dental benefits. The agencies are considering whether to propose an approach under which self-insured limited-scope dental and vision coverage that qualifies as a HIPAA excepted benefit would be excluded from applicable coverage for Cadillac Tax purposes.
- **EAPs –** Employee Assistance Programs that qualify as HIPAA excepted benefits would be excluded from the definition of applicable coverage.

Determining Cost of Applicable Coverage

Cadillac Tax rules provide that the cost of coverage for self insured applicable coverage should be determined by the COBRA applicable premium methods which are the actuarial basis or the past cost methods. The notice provides potential approaches for determining the cost of applicable coverage, specifically addressing proposed approaches to determine "similarly situated" individuals. The agencies expressed concern with plans arbitrarily switching between the two self-insured methods to determine the cost of coverage and the agencies are considering requiring plans to use the chosen valuation method for at least 5 years with limited exceptions. Additional considerations are also addressed regarding the approaches to calculating applicable coverage under each self-insured valuation method.

Interestingly, the notice points out that, while the cost of coverage for Form W-2 reporting purposes is also based on rules similar to COBRA applicable premium rules, interim guidance issued in Notice 2012-9 on W-2 cost of coverage is solely for Form W-2 purposes and is inapplicable to the Cadillac Tax.

Potential methods for determining the cost of HRA coverage are also addressed in the notice. One proposed method determines the cost of applicable HRA coverage based on the HRA amounts made available annually to new participants. An alternative method uses HRA claims and administrative expenses and divides the sum by the number of employees covered for that period for each level of coverage.

The agencies are seeking comments for nearly every aspect of determining the cost of applicable coverage, and are considering other possible methods to determine the cost of applicable coverage. For example, they are determining similar cost of coverage available through the Exchange or based on other actuarial values such as the metal levels (silver, bronze, gold etc.) of Exchange coverage or other measures.

Applicable Dollar Limits

Recognizing that some employees may have self-only coverage and other-than-self only coverage at the same time, the agencies are considering approaches to clarify which limit will apply in such cases. An example given in the guidance is that an employee has self-only major medical coverage, and supplemental coverage, such as a HRA, that covers the employee and the employee's family. Under one of the proposed approaches, the applicable dollar limit would depend on the employee's major medical coverage that accounts for the majority of the aggregate cost of applicable coverage. The following example is provided in the guidance.

> If an employee has applicable coverage with an aggregate cost of $12,000, $3,000 of which is self-only coverage and $9,000 of which is other-than-self-only coverage, the other-than-self-only coverage dollar limit would apply to the full $12,000. If self-only coverage and other-than-self-only coverage make up equal amounts of the aggregate cost of applicable coverage, the other-than-self-only dollar limit would apply to the employee.

An alternative method, which would use a prorated composite dollar limit for each employee according to the ratio of each type of coverage (self only or other-than-self only), is also mentioned and illustrated in the following example.

> If an employee has applicable coverage with an aggregate cost of $12,000 of which $3,000 is self-only major medical coverage and $9,000 is other-than-self-only coverage, the composite dollar limit for the employee to determine excess benefits would be the sum of (1) 25% ($3,000/($3,000 + $9,000)) of the self-only coverage dollar limit and 75% ($9,000)/($3,000 + $9,000) of the other-than-self-only coverage dollar limit.

Adjustments to the statutory dollar limits are addressed and the agencies are seeking comments on a variety of issues including:

- how an employer determines employees ineligible for Medicare under the adjustments for qualified retirees,
- how employers determine whether the majority of employees covered by a plan are high-risk professionals for high risk professions adjustments, and
- whether it is possible to develop safe harbors that adjust the statutory dollar limits for employee populations with age and gender characteristics that are different form those of the national workforce.

What Notice 2015-16 Does Not Address

The agencies note that many issues are not addressed in Notice 2015-16, including procedural issues related to the calculation and assessment of the tax. The agencies anticipate that another notice will follow Notice 2015-16 and the IRS will takes the comments from Notice 2015-16 and the next notice into consideration as the proposed regulations under 4980I are drafted. The agencies further note that the proposed regulations will provide an additional opportunity for comments, including the opportunity to address issues from preceeding notices. Comments for Notice 2015-16 are being accepted until May 15, 2015.

Employer Next Steps

While 2018 may seem well into the distant future for some, employers who offer health coverage should be conscious about the Cadillac Tax. They will likely need to implement measures to either strategically avoid the tax or implement its potential cost into future projections and fiscal budgets.

- Plan sponsor who haven't done so already should start to evaluate their benefit offerings to determine what benefits constitute applicable employer sponsored coverage under their plan.
- Preliminary cost considerations/calculations should be performed to gauge exposure to the tax. Notably, since the tax is assessed on a calendar year, plan sponsors with non-calendar plan years will need to track the excess benefit across plan years and could have to allocate the excess amounts among different insures and/or plan administrators, if applicable.
- Employers who do not structure their benefits to avoid the tax will have to examine ways to pay the additional cost, which may include passing some or all of the cost to employees. While the insurer or plan administrator is obligated to pay the tax in certain cases, it is anticipated that these entities will pass the cost along to the employer.
- In anticipation of the obligations imposed by the Cadillac Tax, employers are encouraged to review all carrier, union and service contracts and consider how the tax may impact agreements effective in 2018 and beyond.

Conner Strong & Buckelew will be hosting a webinar, *Getting Ready for the ACA Cadillac Tax*, on April 16, 2015 from 2:00 – 3:00 PM EST. Plan sponsors concerned with the impact that the Cadillac Tax may have on their health plan offerings are encouraged to attend this webinar. You may register for the webinar by clicking here.

Should you have questions about any aspect of healthcare reform, contact your Conner Strong & Buckelew account representative toll free at 1-877-861-3220. For a complete list of Legislative Updates issued by Conner Strong & Buckelew, visit our online Resource Center.