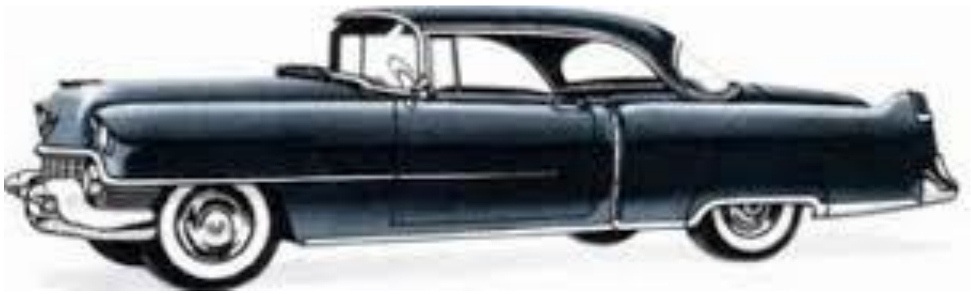
The Cadillac Tax

Looking ahead at the ACA's excise tax on high-cost health coverage



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Cadillac Tax Basics

- **What:** Significant revenue provision of the ACA—40% non-deductible excise tax on high-cost employer-sponsored health coverage (IRC §4980I).

- **When:** Permanent annual tax beginning in 2018

- **Why:** To generate $80 billion over the next 10 years to help finance the expansion of health care

- **Who:** The tax applies to every size company; tax calculated by the employer & payment allocated among coverage providers

Research suggests that more than 60% of employers may be subject to the tax in 2018

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How It Works

- The tax is 40% of the cost of plans exceeding set thresholds. Current limits are $10,200 of coverage for individuals and $27,500 for spouse or family coverage.

- 40% assessed on the *"excess benefit"* or the amounts exceeding the predetermined thresholds.

- The threshold amounts will be updated for 2018 when final regulations are issued and indexed for inflation in future years.

- For **pre-65 retirees** and **individuals in high-risk professions**, the current threshold amounts are $11,850 for individual coverage and $30,950 for other coverage.

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Effective Date

- "Taxable years beginning after December 31st, 2017"→ i.e. **January 1, 2018.**

- Unlike other ACA reforms, the Cadillac tax applies on a *calendar year* basis, regardless of plan year.

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Existing & Future IRS Guidance

- In February 2015 the IRS issued initial guidance via **Notice 2015-16** to begin the process of developing regulations regarding the tax, including issues related to:
  (1) the definition of applicable coverage
  (2) the determination of the cost of applicable coverage, and
  (3) the application of the annual statutory dollar limit to the cost of applicable coverage

- A second notice is anticipated to address outstanding administrative and procedural issues relating to calculating & paying the tax

- Proposed regulations will be released with a formal notice and comment period →Final regulations are to be released by the 1/1/18 effective date

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Which Employers are Subject to the Tax?

- The Cadillac tax applies to all employers who are subject to the excise tax provisions of the Internal Revenue Code, including:
  - Large & small employers
  - Private, for-profit employers
  - Tax-exempt entities (non-profits)
  - Governmental entities
  - Self-employed individuals

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Whose Coverage is Counted?

- "Employee" coverage counts – "employee" defined broadly:
  - Active employees
  - Former employees (no retiree-only exception)
  - Surviving spouse
  - "Other primary insured"

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What Coverage Counts?

→All *"**applicable employer-sponsored coverage.**"* Under current IRS guidance, applicable coverage means:

- All coverage under a "group health plan,"
- Made available to employee by employer,
- Which is excludable from gross income.

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Applicable Employer Coverage

More than major medical. It's Premium +.....

- Retiree-only coverage
- FSAs and HRAs: Aggregate salary reductions + amount reimbursed in excess of salary reductions
- HSAs and Archer MSAs: Employer & employee contributions
- Coverage for specified disease or illness if excluded from income or deduction under §162(l)
- Multiemployer plans
- Executive physical programs
- On-site medical clinics

*The Cadillac Tax is generally applicable regardless of who is paying for the coverage.

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Non-Applicable Coverage

- Coverage only for accident or disability income insurance
- Liability insurance & coverage issued as a supplement to liability insurance
- Worker's Compensation
- Auto Medical Payment Insurance
- Coverage secondary or incidental to medical insurance
- Stand-alone dental/vision
- Coverage for a specified disease or other fixed indemnity coverage paid for with after tax $

Who is responsible for Paying the Tax?

Tax allocated among the "coverage providers"

- Insured Coverage: The coverage provider is the insurer or HMO

- HSA/FSA/HRA & Archer MSA Contributions: The employer is the coverage provider

- For all other plans: **The "person that administers the plan benefits" is the coverage provider**; includes the Plan Sponsor - Employer

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Who is responsible for Calculating the Tax?

- Calculated by employer; allocated by employer

- Reported by employer:
  - Reported on a calendar year basis but calculated separately for each month
  - For plans that are not calendar year plans, employers must include parts of two plan years
  - Determined on an employee-by-employee basis

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Cadillac Tax Calculation

- 40% of the employee's "excess benefit"

- The "excess benefit" is defined as the amount by which the "aggregate cost" of an employee's applicable employer-sponsored coverage for a month exceeds 1/12 of the "annual limitation" for the calendar year which includes that month

- **Aggregate Cost of Coverage Determination:**
  - In general, same rules for determining the applicable premium for COBRA

- **Basic Formula:**
  - $10,200/12= $850 per month; does the aggregate cost exceed this amount?

  - $27,500/12= $2,292 per month; does the aggregate cost exceed this amount?

*Determined using the cost of coverage that the employee is actually enrolled in.

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Examples Based on Current Thresholds

Self-only coverage

A $12,000 individual plan would pay an excise tax of $720 per covered employee:

$12,000 - $10,200 = $1,800 above the $10,200 threshold

$1,800 x 40% = $720

Family coverage

A $32,000 family plan would pay an excise tax of $1,800 per covered employee:

$32,000 - $27,500 = $4,500 above the $27,500 threshold

$4,500 x 40% = $1,800

These charts show how the tax increases as a plan's cost increases:

Self-only coverage

Plan Cost	$11,000	$12,000	$13,000	$14,000	$15,000
Tax	$320	$720	$1,120	$1,520	$1,920

Family coverage

Plan Cost	$28,000	$30,000	$32,000	$34,000	$36,000
Tax	$200	$1,000	$1,800	$2,600	$3,400

Examples based on current thresholds

- Employer with 50 Employees
- Insured Medical Group Health Plan costs: $750/month or <u>$9,000</u>/year for self-only coverage
- Employer HSA Contribution: <u>$1,000</u>/year
- HRA Offered with <u>$2,000</u> available for self-only coverage

$9,000 (GHP)
+ $1,000 (HSA)
+ $2,000 (HRA)

=$12,000 (Aggregate Cost)
- $10,200 (threshold for single coverage)

$1,800 "excess benefit" per EE
x 50 EEs = $90,000 total excess benefit

$90,000 x 40%= **<u>$36,000 Tax</u>**

<u>RESULT:</u>
The $36,000 Excise Tax will be allocated between the providers of coverage: **1)** the insurer/carrier (Medical GHP coverage); and **2)** the Employer (HSA/HRA coverage)

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Example with current premium & 8% annual increase

- **2015:** $750 single monthly premium (or equivalent) = $9,000 annually

Up 8%

- **2016:** $810 single monthly premium=$9,720 annually

Up 8%

- **2017:** $874.80 single monthly premium=$10,497.60 annually

Up 8%

- **2018:** $944.78 single monthly premium=$11,337.40 annually

→With normal premium growth, a $750/month single only plan today will, in 2018, will incur a 40% tax on the "excess" $1,137.40 ($11,337.40-$10,200).

Sample Result: 50 employees x $454.96 (40% of $1,137.40)= **$22,748 tax**

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Penalty for Underpayment

- If the employer or plan sponsor fails to accurately calculate the tax/excess benefit attributable to each coverage provider there will be two results:

1) The coverage provider will be required to pay the amount of the underpaid tax

2) The employer will owe a penalty for miscalculating the tax. **The penalty amount is:** 100% of the additional excise tax due + interest on the underpayment.

**Note: the 4980I tax is explicitly non-deductible.*

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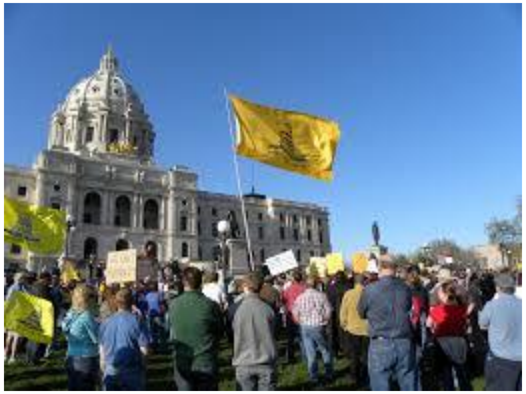
What's next? Possibility of Repeal?

- Politicians, Unions, and Employer Associations are beginning to understand the significant impact this provision will have on American businesses.

- Two bills in the House have been introduced this year to repeal the Cadillac tax:
    - H.R. 879
    - H.R. 2050

- *Even though there is a push to repeal the tax, employers need to plan for it assuming it is still going into effect.*



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How to Plan Now

- Run the calculation of applicable coverage this year
- Evaluate Account Based Plans & CDHP Plans
- Revisit Networks—possible to narrow?
- Change the way that dental and vision coverage is offered
- Use cost-sharing strategies that appropriately influence utilization
- Revisit payroll contribution strategies to drive employees to lower premium plans
- Evaluate self-funded options-may avoid additional charges

➢ Population Management & Wellness Initiatives should start NOW

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Why engage with Marshall & Sterling?

- ✓ Actuarial services & Cadillac tax estimates based on current offerings
- ✓ Plan design analysis and collaboration in crafting lower cost consumer-directed health plans
- ✓ Assistance with implementing incentivized wellness programs
- ✓ Reference- based pricing strategies and custom network arrangements with preferential rates
- ✓ Technology to assist employers in exploring cost-containment strategies that are appropriate for a particular employer’s population
- ✓ Resources available to help with obtaining lower cost services, medications, etc.
- ✓ Cost transparency and plan strategies to reduce overall cost and spend

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Questions?

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