The Cadillac Tax: What We Know & Don't Know

The Patient Protection and Affordable Care Act (the "ACA") introduced a new term into our benefits lexicon: the "Cadillac Tax." Beginning in 2018, the ACA imposes a nondeductible excise tax (the "Cadillac Tax") on employers, health insurance issuers, and/or entities administering plan benefits if the aggregate value of applicable employer-sponsored coverage exceeds the specified threshold limit. The Cadillac Tax is equal to 40% of the aggregate value in excess of the threshold limit. In 2018, the threshold limit is set to be $10,200 for individual coverage and $27,500 for family coverage.

> **Example:** In 2018, Employee A enrolls in self-insured family coverage with an aggregate annual cost of $30,000.
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> Assuming no adjustments are made to the threshold limit, the administrator would be liable for a Cadillac Tax for 2018 for Employee A equal to $1,000 [40% × ($30,000 - $27,500) = $1,000].

With 2018 fast approaching and in response to growing questions from employers, insurers and practitioners, on February 23, 2015 the Department of the Treasury and the IRS ("IRS") finally released guidance on the Cadillac Tax, in the form of Notice 2015-16 (the "Notice"). The Notice is less guidance from the IRS and more of a solicitation of comments to the IRS. Notice 2015-16 describes the approaches IRS is considering with regard to implementation of the Cadillac Tax rules and requests comments on many aspects of the law. **Comments must be submitted by May 15, 2015.**

What We Know: It is Probably Not Going Away

One of the first questions employers ask is why the Cadillac Tax exists at all. If, they reason, one of the underlying reasons for passing the ACA was to promote quality health insurance, why would the same law assess a penalty for providing quality healthcare?

It's an intuitive question with an intuitive answer: for policy and revenue reasons.

As to policy, imposition of the Cadillac Tax, so the economists claim, will bend the cost curve in insurance because it will lead employers to limit or scale back costly plan features. This, of course, ignores the fact that the ACA itself requires many of the same features the economists probably believe will be reduced.

There's another policy reason that is likely more on target than the first (considering the first is based on fiction): to seize revenue to pay for the ACA. On the one hand, the Cadillac Tax raises revenue directly from the health plans in a manner not easily seen by individual taxpayers—if employers continue to offer quality plans, they will be on trend to pay the tax. If they don't, however, the government assumes that employers will "make it up" to employees with taxable wage adjustments. In fact, the Congressional Budget Office ("CBO") has estimated that as much as 70% of revenue raised by the Cadillac Tax will be as a result of taxes on increased wages—this estimate has recently been ratcheted down, but in any event the Cadillac Tax is the consummate revenue raiser: it raises revenue despite any work around.

The second question is whether it is going away? That's hard to predict, of course. So much depends on the 2016 elections. However, assuming the current construct of the ACA remains largely in place, it is hard to see the Cadillac Tax disappearing (at least without some other material revenue generator to take its place).

What We Know: It Applies Broadly to All Types of Plans

The Notice confirms that "applicable employer-sponsored coverage" subject to the Cadillac Tax includes all coverage, regardless of whether the employer or the employee pays for the coverage; the coverage is insured or self-insured; or the coverage is paid for on a pre- or post-tax basis. With respect to the last, this means that with some limited exceptions, employers may not be able to avoid the Cadillac Tax by merely shifting coverage in excess of the statutory dollar thresholds to employees and/or to after-tax coverage. (Stay tuned for more information on this.)

The Notice addresses an issue about self-insured dental and vision coverage that was a particular concern for many employers. The ACA only excluded insured dental and vision benefits from the Cadillac Tax. As has been widely anticipated, the Notice indicates that the IRS is considering adopting an approach where both insured and self-insured dental and vision benefits are excluded from the Cadillac Tax, provided that the benefits are offered under stand-alone plans that otherwise satisfy the revised rules on excepted benefits; a position that would be in accord with the recently issued excepted benefit regulations.

The Notice confirms that applicable coverage includes, but is not limited to, HRAs, health FSAs, HSAs and Archer MSAs, coverage for on-site medical clinics, executive physicals and multiemployer plans.

Some related Cadillac Tax issues being considered by the IRS include:

- *HSAs and MSAs*. The IRS anticipates that future proposed regulations will provide that employer contributions to HSAs and Archer MSAs, including salary reduction contributions, will be included in applicable coverage, and after-tax contributions will be excluded.

- *On-site medical clinics*. The IRS is considering excluding from applicable coverage on-site medical clinics that offer only *de minimis* medical care (e.g., first aid) to employees. The IRS requested comments on this approach, particularly with respect to on-site medical clinics that provide certain services beyond (or in lieu of) *de minimis* care, such as immunizations, injections of antigens, provision of nonprescription pain relievers, and treatment of work injuries (beyond first aid). This is an important issue for employers, especially those who have historically offered robust on-site medical clinics for their employees.

What We Know: It Does Not Apply to Some Types of Plans

The Cadillac Tax does not apply to:

- Accident or disability income insurance, or any combination thereof;
- Coverage issued as a supplement to liability insurance;
- Liability insurance, including general liability insurance and automobile liability insurance
- Workers' compensation or similar insurance;
- Automobile medical payment insurance;
- Credit-only insurance; and
- Other similar insurance coverage, specified in regulations, under which benefits for medical care are secondary or incidental to other insurance benefits
- Coverage for long-term care.

What We Don't Know: Exactly How Threshold Limits Will Be Calculated

We know that the calculation of cost will generally follow the rules applicable to COBRA premiums. However, application of the COBRA rules leads to many questions, which the Notice tells us that the IRS will try to address. Here's what we know and don't know:

- Under COBRA, premium cost is based on the cost of coverage for *similarly situated* non-COBRA beneficiaries. The Notice indicates that the IRS will adopt a similar standard for purposes of the Cadillac Tax. The IRS invites comments on an approach in which a group of similarly situated employees would be determined by starting with all employees covered by a particular benefit package, then subdividing that group based on mandatory disaggregation rules that parse based on whether an employee is enrolled in self-only coverage or other-than-self-only coverage, and then further subdividing based on permissive disaggregation rules (based on the number of individuals covered in addition to the employee, and, potentially, other distinctions traditionally made in the group insurance market).

- Notably, the Notice confirms that the Cadillac Tax rules do not require that the cost of coverage be determined separately based on the number of individuals who are receiving coverage in addition to the employee. In other words, IRS is considering an approach that would permit the use of just one cost of coverage for other-than-self-only coverage (even if the actual cost of such coverage varies depending on how many individuals other than the employee are covered). This suggests that the IRS might permit only two costs of coverage for purposes of the Cadillac Tax (self- and other-than-self-only), even if the COBRA rules would have required a further break down (e.g., employee plus one, employee plus two, family, etc.).

- The COBRA regulations provide two methods for self-insured plans to use when developing the COBRA-applicable premium – the actuarial basis method and the past cost method. To thwart abuse, the IRS is considering a rule that would require the use of one methodology for at least five years for purposes of the Cadillac Tax. The IRS has asked for comments on this approach.

The Notice also addresses a number of other issues concerning the cost of applicable coverage:

- The applicable cost of applicable coverage refers to coverage in which an employee is enrolled, and not coverage that is merely offered to the employee.

- Coverage under a multiemployer plan is treated as other-than-self-only coverage for purposes of the Cadillac Tax.

- The cost of applicable coverage for health FSAs equals the sum of salary reduction contributions and also any reimbursements under the arrangement in excess of the salary reduction contributions, such as employer flex credits.

We don't know yet, however, how the cost of HRA coverage will be determined: the IRS is considering various methods including: (i) basing it on the amounts made newly available to a participant each year; (ii) adding together all claims and administrative expenses attributable to HRAs for a particular period and dividing that sum by the number of employees covered for that period; and (iii) using the actuarial basis method. Comments also were requested on issues relating to whether the cost of applicable coverage should not include (i) an HRA that can be used only to fund the employee contribution toward coverage, and/or (ii) an HRA that can be used to cover a range of benefits, some of which would not be applicable coverage.

So, at this point we know a lot about the Cadillac Tax but still have a lot to learn, particularly in terms of how the cost will be calculated. We know that employers should be focused on the Cadillac Tax and understand that given all of the requirements of the ACA and cost trends generally, the so-called "Cadillac Tax" will be more like a "Chevy Tax." Employers should be working now to control cost trends. Those with union employees should consider the cost of the Cadillac Tax when negotiating contracts that will span past 2018. Everyone should continue to watch for further developments.

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