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IRS Seeks Guidance on Cadillac Tax

One of the impending provisions of the Affordable Care Act (ACA) is the excise tax on high cost group health coverage commonly called “the Cadillac Tax.” This tax is slated to go into effect in 2018.

The IRS recently issued Notice 2015-16 to review the law’s requirements regarding the tax and seek input on issues that should be considered in developing regulations to enforce the tax. This issue of *Legislative Review* provides an overview of the IRS notice.

Cadillac Tax – Background

The Cadillac tax is a nondeductible 40% excise tax on high-cost employer health plans. **The thresholds established in the law to trigger the tax are \$10,200 for individual coverage and \$27,500 for family coverage.** The thresholds are to be indexed based on the general inflation rate.

As with many laws passed by Congress, new spending is offset by spending cuts or other added revenue. The Cadillac tax is one of the provisions in the ACA that helps pay for the law. It was initially expected to generate more than \$12 billion in the first year when it kicks in in 2018.

Revised Congressional Budget Office figures predict a 41% drop in their most recent Cadillac tax projections with the new estimate of \$87 billion over ten years. The revision reflects a slowing in overall health costs as well as steps already taken by employers to scale back benefits in anticipation of the tax.

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Letter from Karen Knippen

It sounds funny to say that we’ve been anxiously awaiting guidance on the so-called “Cadillac tax.” But, as advisors to our clients, we need to have this guidance to help our clients develop a strategy to address the tax.

Some employers are already taking steps to revise their plans in an effort to avoid the tax triggers. Still others are planning multiple steps to avoid abrupt changes to their plans year-over-year in preparing for the implementation of the tax.

Still other employers are taking a wait and see attitude, hoping that, like a number of the provisions of the ACA, that this tax will be eliminated or mitigated.

As brokers, we can only offer guidance based on what the law and the regulators have told us. As such, I know many of my colleagues are pleased to see this first step toward more definitive guidance.

Sincerely yours,



Karen Knippen, RHU, REBC, CLTC
Senior Vice President

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Notice 2015-16

The notice provides the first look at the Treasury Department's thinking regarding the excise tax. The Treasury Department and associated agencies are using the notice to seek out comments on a number of issues related to the tax, including:

- The definition of applicable coverage
- The determination of the cost of coverage
- Adjustments to the thresholds of the tax, including adjustments based on a group's age, gender makeup, retirees and high-risk professions.

Comments are due by May 15, 2015.

Definition of Applicable Coverage

Applicable coverage as stated in Section 49801(d)(1)(A) means:

“with respect to any employee, coverage under any group health plan made available to the 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 (within the meaning of section 106).”

The term “group health plan” means a plan, including both insured and self-insured plans.

The types of coverage included in applicable coverage are:

- Health FSAs
- Archer MSAs
- HSAs
- Governmental plans defined as those providing coverage for civilian employees including federal, state and other governmental employee plans

- On-site medical clinics
- Retiree coverage
- Multiemployer plans
- Specified disease coverage.

Further guidance is forthcoming regarding whether HRAs and executive physical programs are applicable coverage.

Coverage Types Excluded from Applicable Coverage

The excluded coverages include:

- Certain excepted benefits
- Accident and disability income insurance
- Coverage issued as a supplement to liability insurance
- Workers' compensation
- Automobile medical payment insurance
- Credit-only insurance
- Other coverage where medical care is secondary or incidental to the insurance benefits
- Long-term care insurance
- Most dental and vision insurance that is a separate policy
- Specified illness or disease coverage that is a fixed indemnity.

HSAs and MSAs

Future regulations will provide that employer contributions to HSAs and MSAs, including salary reduction contributions to HSAs will be considered “applicable coverage.” Employee after-tax contributions to HSAs and MSAs will be excluded.

On-site Medical Clinics

On-site medical clinics that provide only de Minimis care will likely be excluded. The notice cites COBRA regulations regarding the treatment of clinics in determining if they are – or are not – a group health plan.

EAPs

The agencies are considering excluding EAPs from the definition of applicable coverage. They are seeking comments on implementing this approach.

Determining the Cost of Applicable Coverage

The excise tax is a 40% excise tax on the excess amount of the “aggregate cost of the applicable coverage of an employee for a month over the applicable dollar limit for the month.” The determination of applicable premium will likely follow the methodology used to determine applicable premium for COBRA purposes.

The COBRA premium calculation is straightforward for most insured plans. It is more complicated for self-funded plans. These plans use either of two (2) methods:

1. The actuarial basis method
2. The past cost method.

Odds and Ends

The “good news” is that the cost of applicable coverage will not include any portion of the cost of coverage attributable to the excise tax.

The cost of applicable coverage must be calculated separately for self-only and other than self-only coverage.

A plan may elect to treat retirees who have not attained age 65 and retired employees over the age of 65 as similarly situated employees. This may allow an employer to base the cost of applicable coverage on the average cost of that type of applicable coverage rather than for all employees. **Furthermore, the agencies are considering allowing employees enrolled in different benefit packages to be grouped separately.**

The tax will be based on coverage in which an employee has enrolled. Certain sections of the statute refer to coverage that is “made available” rather than enrollment.

Adjustments

The Act refers to adjustments of the taxable amount in consideration of retirees, high-risk professions and when the age and gender characteristics of an employer are different from those of the national workforce. Comments are requested on how employers will determine whether they meet any of these criteria to adjust the taxable amount.

The baseline tax threshold of \$10,200 for self-only coverage and \$27,500 for other than self-only coverage can be adjusted according to the law. Proposed rules to be published will include rules regarding these adjustments and invite comments on the adjustment limits.

Strategies for Employers

Employers may want to consider changes to their plans to mitigate the excise tax. Strategies to consider include:

- Higher deductibles
- Higher out-of-pocket expenses
- Lower subsidies to spouse/family
- Limit contributions to HSAs, FSAs, HRAs.

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Inside:

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