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Initial Notice: Tax on High-Cost "Cadillac" Employer-Sponsored Health Coverage

OVERVIEW

On February 23rd, the Internal Revenue Service (IRS) released an initial notice on the excise tax on high-cost employer-sponsored health coverage, otherwise known as the "Cadillac tax." As required by the Affordable Care Act (ACA), if employer-sponsored coverage provided to an employee exceeds a statutory dollar limit, the excess is subject to a 40% excise tax. The tax applies beginning January 1, 2018.

The notice (available here) describes potential approaches that could be incorporated in proposed regulations regarding:

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.

The IRS invites public comment on these approaches through May 15th.

The IRS intends to issue an additional notice on issues not addressed in this notice, including procedural issues relating to the calculation and assessment of the excise tax. After considering the comments it receives on both notices, the IRS will issue a proposed rule with comment period.

DEFINITION OF APPLICABLE COVERAGE

Coverage applicable under the Cadillac tax includes coverage under any group health plan which is excludable from the employee's gross income, or would be excludable it if were employer-provided coverage. This definition also includes self-insured plans. The following types of coverage also constitute applicable coverage:

- Multi-employer plans;
- Health FSAs;
- Archer MSAs, except employee after-tax contributions;
- HSAs, except employee after-tax contributions;
- Governmental plans, except those provided to members of the military and their families;
- Coverage for on-site medical clinics;
- Retiree coverage; and
- Coverage only for a specified disease or illness and hospital indemnity or other fixed indemnity insurance if the payment for the coverage is excluded from gross income.

Other types of coverage, such as executive physical programs and Health Reimbursement Arrangements (HRAs) meet the general definition of applicable coverage and are not specifically excluded. The IRS expects to include executive physical programs and HRAs as applicable coverage in future rulemaking.

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Excluded Coverage

The following types of coverage are excluded from the excise tax:

- Accident and/or disability income insurance;
- Liability insurance, including general liability insurance, automobile liability insurance, and supplements to liability insurance;
- Workers' compensation;
- Automobile medical payment insurance;
- Credit-only insurance;
- Long-term care insurance;
- Separate policies for the treatment of the mouth or eye; and
- Coverage only for a specified disease or illness and hospital indemnity or other fixed indemnity insurance if the payment for the coverage is not excluded from gross income.

The IRS is considering whether Employee Assistance Programs[1] (EAPs) and/or self-insured limited scope dental and vision coverage should be excluded from the excise tax as well.

DETERMINING THE COST OF COVERAGE

According to statute, the cost of applicable coverage will be determined under rules similar to those used to determine Consolidated Omnibus Budget Reconciliation Act (COBRA) premiums. The notice details how components of the COBRA model could be extended to calculating the cost of applicable coverage under the tax.

Similarly Situated Individuals

A COBRA premium is generally based on the average cost of providing coverage to plan members who are "similarly situated", instead of based on the characteristics of each individual. The cost of applicable coverage must be calculated separately for self-only coverage and other-than-self-only coverage.

Under the potential approach that the IRS is considering, each group of similarly situated employees would be determined by starting with all employees covered by a particular benefit package by the employer. The employees enrolled in each different benefit package would be grouped separately. Benefit packages would be considered different based upon differences in health plan coverage and there may be more than one benefit package provided under a group health plan.

The employer would then be required to separate employees within the group based on whether an employee had enrolled in self-only coverage or other-than-self-only coverage. However, within a group of employees who are receiving other-than-self-only coverage, an employer would not be required to further divide the employees based on the number of individuals covered by the policy. Any coverage under a multiemployer plan is treated as other-than-self-only coverage.

The IRS is also considering permitting, but not requiring, further disaggregation based on distinctions that have traditionally been made in the group insurance market, including nature of compensation,

[1] An EAP is a voluntary, work-based program that offers free and confidential assessments, short-term counseling, referrals, and follow-up services to employees who have personal and/or work-related problems.

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specified job categories, and collective bargaining status. The IRS would also consider creating a more specific standard which would only allow disaggregation based on limited specific categories. In either case, criteria related to an individual's health would be prohibited. The IRS invited comments on these potential approaches.

Self-Insured Methods

The IRS is considering providing self-insured plans with two options to determine the applicable premium. The first method would determine the premium on an actuarial basis and take into account additional factors that would be specified in future rulemaking. The second method would use past costs to determine premiums. The IRS intends to prohibit the use of the past cost method in cases where there have been significant changes in benefits, employees covered by the plan, or other factors. The IRS is also considering proposing that a plan would be required to use the method that it chooses for a period of at least five years.

APPLICATION OF DOLLAR LIMIT

The tax is only applied to what is known as the "excess benefit." This is the amount in excess of the annual dollar limit. Every year, there are two different annual dollar limits: one for self-only coverage and another for other-than-self-only coverage. In general, the limit applies on a monthly prorated basis when an employee is provided coverage as of the beginning of the month. The dollar limits for 2018 are $10,200 for self-only coverage and $27,500 for other-than-self-only coverage.

Both Self-Only and Other-Than-Self-Only Applicable Coverage

An employee may simultaneously have coverage to which the self-only dollar limit applies and coverage to which the other-than-self-only dollar limit applies. For example, an employee make have self-only major medical coverage and an HRA that covers the employee as well as the employee's family. As a result, the IRS is considering an approach in which the employee's primary/major medical coverage would dictate the type of dollar limit that applies. For example, 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 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.

The IRS is also considering an alternative approach that would apply a composite dollar limit according to the ratio of the cost of the self-only coverage and the other-than-self-only coverage. The IRS invites comments on these potential approaches.

Adjustments

The statue provides that various adjustments to increase the annual dollar limits. The IRS intends to include rules regarding these adjustments in proposed regulations.

The statute provides that a "health cost adjustment percentage" will be applied to the baseline per-employee dollar limits for 2018 to determine the actual applicable dollar limits for that year. In taxable years after 2018, a cost-of-living adjustment will be applied to determine the applicable dollar limits.

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Annual limits may also be adjusted for:

- Qualified retirees;
- High-risk professions, such as law enforcement officers, fire fighters, and individuals who provide out-of-hospital emergency medical care such as emergency medical technicians, paramedics, and first-responders; and
- Age and gender, if the age and gender of the employer's workforce are different from the national workforce average.

OTHER METHODS

The IRS notes that some stakeholders have suggested that the cost of applicable coverage could be determined using a method other than the COBRA method. This may include using a reference to the cost of similar coverage available through the exchanges. Some stakeholders have also questioned whether the cost of applicable coverage for an employee could be determined based on actuarial values or other metrics. The IRS invites comments on whether any alternative approaches to demining the cost of applicable coverage would be consistent with statutory requirements.