

Cadillac Tax – 2015 IRS Notices

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The Internal Revenue Service (IRS) has released two separate notices this year requesting comments on how to administer the excise tax on high-cost health coverage (also known as the “Cadillac tax”) set to go into effect for the 2018 tax year. The notices described potential approaches to various aspects of the excise tax and requested public comment on a number of issues. These notices provide some indication of which way the IRS is leaning regarding the administration of the tax, but we will know more once proposed regulations are released later this year or early next year.

Background

The so-called “Cadillac tax,” which goes into effect starting with the 2018 tax year, is a 40% non-deductible excise tax on a portion of the cost of high-cost health coverage. The tax applies to the amount by which the monthly cost of certain employer-sponsored coverage exceeds an annual threshold amount defined in the law. The threshold amounts, prior to potential upward adjustments (see more below), are \$10,200 for self-only coverage and \$27,500 for coverage other than self-only. The cost of applicable coverage refers to coverage in which the employee is actually enrolled (rather than only offered or eligible for).

The employer will be responsible for calculating the excess amount, if any, and reporting such amounts to the IRS and to applicable coverage providers. The coverage provider is then responsible for actually paying the tax. If the coverage is insured, the “coverage provider” responsible for paying the tax is the insurer. For other coverage, the “coverage provider” may be the employer or “the person that administers the plan benefits.” However, either way, the tax will generally be passed back to employers. It is expected at this time that the taxes will be paid using Form 720, like the PCORI fees.

Applicable Employer-Sponsored Coverage

The excise tax on high-cost health coverage applies to “applicable employer-sponsored coverage,” which generally includes:

- Health flexible spending accounts (FSAs);
- Health savings accounts (HSAs) or Archer medical savings accounts (MSAs);
- Government-sponsored plans for civilian employees (exclusion for military coverage);
- Some on-site medical clinics;
- Retiree coverage;
- Multi-employer (union) plans; and
- Specified disease or illness coverage or indemnity coverage if provided on a pre-tax basis.

The following are generally not included:

- Limited scope vision or dental coverage that qualifies as an expected benefit;
- Coverage only for accident, or disability income insurance;
- Liability insurance,
- Workers' compensation;
- 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.

As indicated in the notices, future guidance is expected to provide that:

- Executive physical programs and HRAs are applicable coverage.

- Employer contributions to HSAs and Archer MSAs, and employee pre-tax salary reduction contributions to HSAs, are included in applicable coverage.
- Onsite medical clinics that offer only de minimis medical care to employees will be excluded from applicable coverage.

Cost of Applicable Coverage

Generally, the cost of applicable coverage is “determined under rules similar to the rules” under COBRA for determining the COBRA applicable premium. COBRA rules currently require a self-funded plan to use either an actuarial basis or the past-cost method to determine the applicable premium. The IRS addressed the following cost issues in the two notices:

- In regard to using the COBRA method of determining the applicable premium, additional guidance is needed (not currently provided for COBRA calculations either).
 - It is anticipated that self-funded plans will use either the actuarial basis or the past cost method, but further detailed guidance will be provided for such methods.
 - It is also anticipated that further guidance will be provided on how to determine the applicable premium for HRAs.
- If an employee has both self-only coverage and other than self-only coverage (such as an employee who is enrolled in single medical coverage but has a health FSA that reimburses costs for the entire family), the IRS is considering two possible approaches to clarify the application of the dollar limit:
 1. The applicable dollar limit for an employee would depend on the level of coverage under the employee’s primary major medical coverage.
 2. A composite dollar limit would be determined by prorating according to the ratio of the cost of the self-only coverage and the cost of the other-than-self-only coverage.
- It is anticipated that the taxable period will be the calendar year, regardless of the employer’s plan year. The IRS acknowledges that potential timing issues will be different depending on the type of plan (e.g., claim submission for self-funded plans, run-out periods for health FSAs, premium discounts for fully insured plans) and has requested comments on these timing issues.
- The excise tax is not deductible, so the coverage provider will experience an increase in taxable income due to the excise tax reimbursement, in addition to the actual excise tax. While the IRS expects to exclude the excise tax from the cost of applicable coverage in future guidance, they are also considering whether the income tax may be excluded as well.

The regulations provide specific guidance for determining the cost of a health FSA. In determining the portion of the cost of applicable coverage attributable to non-elective flex credits contributed to an FSA by an employer (either in combination with employee salary reduction contributions or without), the cost of the non-elective flex credit would be the amount that is actually reimbursed in excess of the employee’s salary reduction election for that plan year.

Threshold Amount Adjustments

In accordance with the statute, no downward adjustments can be made. Therefore, the threshold amounts can be increased only from \$10,200 for self-only coverage and \$27,500 for other than self-only coverage. Obviously any increase in the threshold amount will result in a reduction in the plan’s tax liability since the tax would apply to a smaller excess cost.

The adjustments that apply to the threshold amounts are as follows:

- A health cost adjustment percentage that allows for a one-time adjustment (2018 only) if actual increases in the cost of health care between passage of the health care reform law in 2010 and implementation of the high-cost coverage excise tax in 2018 exceed 55%;
- A cost-of-living adjustment for calendar years after 2018 to reflect changes in the cost of living;
- An adjustment for qualified retirees, defined as “any individual who (A) is receiving coverage by reason of being a retiree, (B) has attained age 55, and (C) is not entitled to benefits or eligible for enrollment under the Medicare program under title XVIII of the Social Security Act;”

- An adjustment for an individual “who participates in a plan sponsored by an employer the majority of whose employees covered by the plan are engaged in a high-risk profession or employed to repair or install electrical or telecommunication lines;” and
- A possible age and gender adjustment for employees of a particular employer to reflect substantial changes in the age and gender characteristics of a group.

It is important to note that there has been no indication from the IRS that type of geographic or area adjustment to the threshold amounts will be available. This is of particular concern for employers who have employees in areas of the country with higher than average health plan costs.

Penalties

If the tax is miscalculated, it is the employer who will be penalized, not the coverage provider (although the coverage provider will have to pay any adjustments). The penalty amount is 100% of the additional excise tax that must be paid by coverage providers due to the miscalculation. In addition to the 100% penalty, the employer or plan sponsor must also pay interest on the underpayment for the period beginning on the due date for the unpaid amount and ending on the date of payment of the penalty. IRS may provide forgiveness for some or all of the penalty if the employer (or plan sponsor) can prove reasonable diligence or that there is reasonable cause and not willful neglect.

Summary

Employers preparing for this tax may choose to adjust benefit plan offerings by implementing plans with higher deductibles and/or increasing cost-sharing, as well as reconsidering the offering of various account-based plans such as health FSAs, HRAs and HSAs to ultimately reduce the aggregate cost of applicable coverage provided to employees.

It is clear that the calculation and reporting of the cost of applicable coverage will be the responsibility of the employer, although the time frames and exact methods for calculation and reporting are still being clarified. The IRS guidance provides some insight into how the administration of the “Cadillac tax” will be handled, but nothing is definite at this point. While many employers may be evaluating current plan benefits and considering potential future options, further clarification and guidance provided by the IRS in the proposed rules will provide more certainty as to which group health plans must be included, how to calculate the applicable coverage cost, and how the threshold amounts will be adjusted.

Notice 2015-16 can be found [here](#)

Notice 2015-52 can be found [here](#)

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