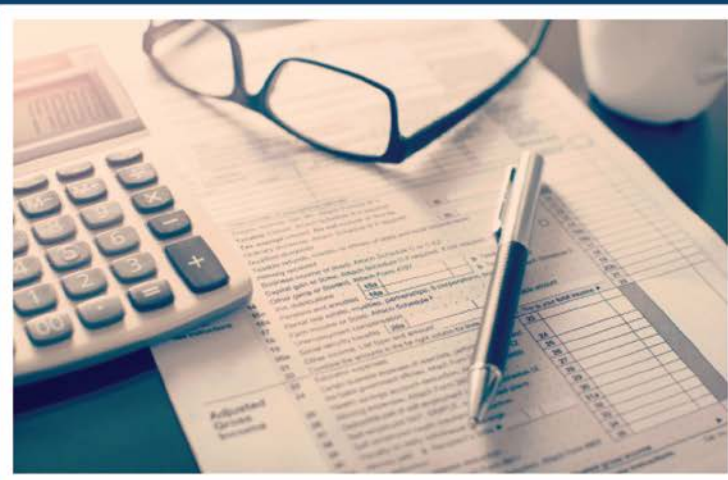


# CADILLAC TAX

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Provided by Lawley

## “Cadillac” Tax on High-cost Health Coverage

The Affordable Care Act (ACA) imposes a 40 percent excise tax on high-cost group health coverage, also known as the “**Cadillac**” tax. This provision, found in Internal Revenue Code (Code) Section 49801, taxes the amount, if any, by which the monthly cost of an employee's applicable employer-sponsored health coverage exceeds the annual limitation (called the employee's **excess benefit**). The tax will be calculated by the employer and paid by the coverage provider.

**Proposed or final regulations have not yet been issued on the ACA's Cadillac tax.** The Internal Revenue Service (IRS) issued some guidance describing potential approaches for a number of issues and invited comments on these approaches. Taxpayers may not rely on this guidance, although some approaches could be incorporated in future regulations. The IRS is expected to issue final guidance on the Cadillac tax requirement before it becomes effective in 2022.

### LINKS AND RESOURCES

- Enacted on Dec. 18, 2015, a [2016 federal budget bill](#) delayed implementation of the Cadillac tax until 2020. Then, on Jan. 22, 2018, a [continuing resolution](#) delayed implementation of the Cadillac tax for an additional two years, until 2022.
- On Feb. 23, 2015, the IRS issued [Notice 2015-16](#) to begin the process of developing guidance to implement the Cadillac tax. Then, on July 30, 2015, the IRS issued [Notice 2015-52](#) to supplement Notice 2015-16.

### Purpose of the Cadillac Tax

The Cadillac tax is intended to:

- Encourage companies to choose lower-cost health plans for their employees; and
- Raise revenue to fund other ACA provisions.

### Effective Date

- The Cadillac tax was originally intended to take effect in 2013, but was immediately delayed until 2018 following the ACA's enactment.
- However, a 2016 federal budget bill enacted on Dec. 18, 2015, **further delayed implementation of this tax until 2020.**
- Then, a continuing resolution enacted on Jan. 22, 2018, **delayed implementation for an additional two years, until 2022.**

This ACA Overview is not intended to be exhaustive nor should any discussion or opinions be construed as legal advice. Readers should contact legal counsel for legal advice.

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## TYPES OF COVERAGE SUBJECT TO THE CADILLAC TAX

The Cadillac tax applies to “applicable employer sponsored coverage.” Applicable employer-sponsored coverage is, with respect to any employee, coverage under any group health plan made available to the employee by the employer, which is excludable from the employee’s gross income under Code Section 106. “Employee” includes any former employee, surviving spouse or other primary insured individual.

The Code’s aggregation rules apply for companies that are related or commonly owned. Thus, all employees who are treated as being employed by a single employer under the controlled group or affiliated service group rules in Code Sections 414(b), (c), (m) or (o) are treated as being employed by a single employer for purposes of the Cadillac tax.

Generally, applicable employer-sponsored coverage includes **governmental plans**. In addition, coverage under any group health plan for a **self-employed individual** will be treated as applicable employer-sponsored coverage, and will be subject to the Cadillac tax, if a deduction is allowable under Code section 162(l) for the cost of that coverage.

**Notice 2015-16 includes potential clarifications on the definition of “applicable coverage”:**

- The IRS expects future guidance to include executive physical programs and HRAs as applicable coverage.
- The IRS anticipates that future regulations will exclude on-site medical clinics that offer only de minimis medical care to employees from the definition of applicable coverage.
- The IRS invited comments on how to treat on-site medical clinics that provide certain services in addition to (or in lieu of) first aid.
- The IRS is considering whether to propose approaches under which self-insured limited scope dental and vision coverage and certain employee assistance programs (EAPs) that qualify as an excepted benefit under the amended excepted benefits regulations would be excluded from applicable coverage for purposes of the Cadillac tax.

### **Coverage Not Subject to the Tax**

The Cadillac tax does *not* apply to coverage for long-term care and any coverage that is considered an “excepted benefit,” other than coverage for on-site medical clinics.

**Excepted Benefits**

- Accident-only or disability income insurance (or any combination thereof);
- Supplemental liability insurance;
- Liability insurance, including general 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.

Likewise, separate dental and vision plans that constitute excepted benefits are not subject to the Cadillac plan tax. Independent, non-coordinated coverage for a specified disease or illness only, or hospital indemnity or other fixed indemnity insurance, is also not subject to the Cadillac tax if:

- It is paid for exclusively with after-tax dollars; and
- In the case of self-employed individuals, a deduction under Code Section 162(l) is not allowable.

### ***Deductibility of the Cadillac Tax***

As enacted by the ACA, the Cadillac tax was not deductible as a business expense. However, the 2016 federal budget removed this provision, so that **the Cadillac tax, once enacted, is now deductible.**

### **RESPONSIBILITY FOR CALCULATING AND PAYING THE TAX**

Employers will be responsible for calculating the Cadillac tax owed for each employee’s employer-sponsored coverage, as well as the share attributable to each coverage provider. In the case of **multiemployer plans**, the plan sponsor will be required to calculate and report each coverage provider’s portion of the taxable excess amount. In addition, employers or plan sponsors will be responsible for reporting the taxable excess benefit attributed to each coverage provider to both **that coverage provider** and to the **IRS**.

The term plan sponsor means:

- The **employer**, for an employee benefit plan established or maintained by a single employer;
- The **employee organization**, for a plan established or maintained by an employee organization; or
- The association, committee, joint board of trustees or other similar group of representatives of the parties who establish or maintain the plan, for a plan established or maintained by two or more employers or jointly by one or more employers and one or more employee organizations.

Responsibility for paying the Cadillac tax falls on the “**coverage provider**.” Depending on the type of coverage, this can be the insurer, the employer or a third-party administrator (TPA). For example:

<b>IF COVERAGE IS:</b>	<b>THE COVERAGE PROVIDER IS:</b>
Health Insurance Coverage	The health insurance issuer
HSA or Archer MSA Contributions	The employer
Other coverage	The person that administers the plan benefits

If an employee has more than one type of coverage, each coverage provider will be responsible for paying their “applicable share” of the employee’s excess benefit. A coverage provider’s **applicable share** is calculated based on the percentage of the employee’s aggregate cost of coverage that is provided by that coverage provider.

The ACA does not define the term “person that administers the plan benefits,” except that this term includes the plan sponsor, if the plan sponsor administers benefits under the plan. According to Notice 2015-52, the IRS is considering two alternative approaches to determining the identity of the person that administers the plan benefits:

- **Option 1:** The person that administers the plan benefits would be **the person responsible for performing the day-to-day functions that constitute the administration of plan benefits**, such as receiving and processing claims for benefits, responding to inquiries or providing a technology platform for benefits information. The IRS anticipates that this person generally would be a TPA for benefits that are self-insured.
- **Option 2:** The person that administers the plan benefits would be the person that has the ultimate authority or responsibility under the plan with respect to the administration of plan benefits (including final decisions on administrative matters), regardless of whether that person routinely exercises that authority or responsibility. The IRS anticipates that this person would be identifiable based on the terms of the plan documents and often would not be the person that performs the day-to-day routine administrative functions under the plan.

### ***Employer Aggregation***

For purposes of the Cadillac tax, all employers treated as a single employer under Code Section 414(b), (c), (m) or (o) are treated as a single employer. In Notice 2015-52, the IRS invited comments on practical challenges presented by the application of those aggregation rules to the Cadillac tax provision, including the identification of:

- The applicable coverage taken into account, as made available by an employer;
- The employees taken into account for the age and gender adjustment and the adjustment for employees in high-risk professions or who repair/install electrical or telecommunications lines;
- The taxpayer responsible for calculating and reporting the excess benefit; and
- The employer liable for any penalty for failure to properly calculate the Cadillac tax imposed.

### **CALCULATING THE CADILLAC TAX**

The Cadillac tax is calculated for each taxable period with respect to an employee's applicable employer-sponsored coverage, and equals **40 percent** of the employee's “excess benefit.” Generally, the taxable period is a calendar year, although the ACA allows the IRS to prescribe different taxable periods for employers of varying sizes. However, according to Notice 2015-52, the IRS anticipates that the taxable period will be the calendar year for all taxpayers.

An employee's **excess benefit** is the sum of the employee's monthly excess amounts for the taxable period. The excess amount is the amount, if any, by which the aggregate cost of the employee's applicable employer-sponsored coverage for the month exceeds 1/12 of the annual limitation for the calendar year.

## Aggregate Cost of Employer-Sponsored Coverage

The aggregate cost of an employee’s applicable employer-sponsored coverage is the **sum of the costs for each coverage**. In general, the cost of a particular coverage is determined under rules similar to the rules for determining the “applicable premium” for COBRA purposes. The applicable premium is the plan’s cost for providing coverage.

For purposes of the Cadillac tax, separate cost amounts must be calculated for individual and family coverage, even if, for COBRA purposes, the plan calculates only one premium for all qualified beneficiaries. The aggregate cost of coverage *does not include* the cost of any excise tax due. Employers must use the **monthly** aggregate cost of each applicable employer-sponsored coverage to determine the Cadillac tax amount due. If cost is ordinarily determined on a basis other than monthly, the cost must be allocated to the months in the taxable period in a manner that will be described in future IRS guidance.

For retiree coverage, employers may treat retired employees who have not attained age 65 as “similarly situated” to retired employees who have attained age 65, so that both have the same cost of coverage. Special rules also apply for determining the cost of account-based coverage, such as health flexible spending accounts (health FSAs), health savings accounts (HSAs) or Archer MSAs.

HEALTH FSAs	HSAs OR ARCHER MSAs
<p>The cost of the health FSA coverage is the sum of the <b>employee’s salary reduction contributions</b> plus the cost of any <b>reimbursement in excess</b> of the employee’s salary reduction contributions.</p> <p>If reimbursements are limited to the amount of the employee’s salary reduction contributions, the cost of coverage will be the dollar amount of the employee’s aggregate salary reduction contributions for the year.</p>	<p>The cost of the HSA or Archer MSA coverage is the amount of the <b>employer’s contributions</b>. If employees make salary reduction contributions to an HSA through the employer’s cafeteria plan, those contributions should be considered employer contributions and counted toward the cost of the HSA coverage.</p> <p>Other contributions, such as employee contributions made outside a cafeteria plan, will not be counted toward the cost of coverage.</p>

A number of issues arise in calculating the COBRA applicable premium, including how to determine which non-COBRA beneficiaries are similarly situated, methods for self-insured plans to determine the applicable premium and how to determine the applicable premium for HRAs, Archer MSAs, FSAs and HSAs. Notice 2015-16 and Notice 2015-52 describe potential approaches for each of these issues for purposes of the Cadillac tax. The IRS is also considering whether these potential approaches should apply for determining the COBRA applicable premium.

- The COBRA applicable premium is based on the cost of coverage for similarly situated non-COBRA beneficiaries. The IRS anticipates that a somewhat similar standard will apply for the Cadillac tax, where the cost of the applicable coverage for an employee will be based on the average cost of that type of applicable coverage for that employee and all similarly situated employees. The IRS invited comments on this potential approach, including areas where more guidance would be

beneficial. Future guidance will likely attempt to harmonize the COBRA rules with the Cadillac tax rules (although some differences may be appropriate).

- Currently, there are two methods for self-insured plans to calculate the COBRA applicable premium—the actuarial basis method and the past cost method. The IRS anticipates that, in general, these two methods will apply for determining the cost of applicable coverage for self-insured plans for purposes of the Cadillac tax, and it is seeking comment on this approach.
  - **Actuarial Basis Method**—The cost is equal to a reasonable estimate of the cost of providing coverage for similarly situated beneficiaries determined on an actuarial basis, taking into account “such factors as the Secretary may prescribe in regulations.”
  - **Past Cost Method**—The cost is equal to the cost to the plan for similarly situated beneficiaries for the same period occurring during the preceding determination period, adjusted by the percentage increase or decrease in the implicit price deflator of the gross national product for the 12-month period ending on the last day of the sixth month of the preceding determination period. The past cost method cannot be used in cases where there has been a significant change in coverage under the plan or in employees covered by the plan.
- Instead of determining the cost of applicable coverage using rules similar to the COBRA applicable premium rules, some have suggested that this could be determined by reference to the cost of similar coverage available elsewhere (for example, through an Exchange), whether or not based on actuarial values, metal levels (bronze, silver, etc.) or other metrics. The IRS invited comments on other alternative approaches.
- The IRS is considering an approach for calculating the cost of applicable coverage for HSAs, Archer MSAs, FSAs and HRAs that are applicable coverage. Under this allocation rule, contributions to account-based plans would be allocated on a pro-rata basis over the period to which the contribution relates (generally, the plan year), regardless of the timing of the contributions during the period. For example, if an employee elects to contribute to an FSA for a plan year, the employee’s total contributions would be allocated ratably to each calendar month of the plan year, even though the entire amount would be available to reimburse qualified medical expenses on the first day of the plan year.
- Certain challenges arise when determining the cost of applicable coverage of an FSA. In general, the cost of applicable coverage of an FSA for any plan year would be the greater of the amount of an employee’s salary reduction or the total reimbursements under the FSA. The IRS is considering providing a **safe harbor** to avoid double counting when taking into account salary deferral amounts that are carried over from one year to another year in determining the cost of coverage in both the year of contribution and the subsequent year. Under this safe harbor, the cost of applicable coverage for the plan year would be the amount of an employee’s salary reduction **without regard to carry-over amounts**. Unused amounts that are carried over would be taken into account when initially funded by salary reduction, but would be disregarded when used to reimburse expenses in a later year. This possible safe harbor would be limited to cases in which nonelective flex credits are not available for use in the FSA. To address situations in which



nonelective flex credits are available under a cafeteria plan that includes an FSA, the IRS is considering a variation on the safe harbor that would allow an FSA with nonelective flex credits to be valued under the safe harbor in certain situations.

The IRS anticipates that the method for calculating the cost of applicable coverage would be elected prior to the period for which the cost applies, under similar rules as the COBRA applicable premium. Notice 2015-16 and Notice 2015-52 invited comments on whether the COBRA rules should apply for purposes of the Cadillac tax, and whether more guidance would be beneficial.

Employers will calculate the amount of any Cadillac tax that a coverage provider may owe for a taxable period, and then must notify both the IRS and the coverage provider of the amount of the excess benefit, and the tax must be paid by the coverage provider. Accordingly, the IRS anticipates that employers will have to determine the cost of applicable coverage for a taxable year sufficiently soon after the end of that taxable year in order to enable coverage providers to pay any applicable tax in a reasonably timely manner.

Taking into account the potential approaches in Notice 2015-16 for determining the cost of applicable coverage, as well as other issues with timing implications, the IRS requested comments in Notice 2015-52 on the processes expected to be involved in calculating and allocating any excess benefit and the time period necessary to complete these processes.

### ***Annual Limitation***

The annual limitation applicable to a particular employee's coverage is based on a statutory dollar amount. For most employees, the initial dollar amount for purposes of calculating an employee's excess benefit is **\$10,200** for individual coverage and **\$27,500** for other than individual coverage. However, higher initial dollar amounts of **\$11,850** for individual coverage and **\$30,950** for other than individual coverage apply for:

- **Qualified retirees** (individuals who are receiving coverage by reason of being a retiree, have attained age 55 and are not entitled to benefits or eligible for enrollment under Medicare); and
- Participants in plans sponsored by employers, a majority of whose covered employees work in certain high-risk professions or are employed to repair/install electrical/telecommunications lines.

**High-risk professions include:**

- Law enforcement officers;
- Employees in fire protection activities;
- Individuals who provide out-of-hospital emergency medical care (including emergency medical technicians, paramedics and first-responders);
- Individuals in the construction, mining, agriculture (but not food-processing), forestry and fishing industries;
- Individuals whose primary work is longshore work; and
- Employees who retired from a listed high-risk profession, if he or she was in a high-risk profession for at least 20 years.

Note that a special rule in the statute **treats any coverage under a multiemployer plan as “other than self-only”** (that is, family) coverage, regardless of the type of coverage provided to the employee. Thus, it appears that multiemployer plan sponsors can always use the family dollar amount to calculate the excise tax. However, it is unclear whether this rule applies if the multiemployer plan fails to provide minimum essential coverage or provides varying benefits that would prevent other plans from using the family coverage dollar limit.

The annual limitation will be adjusted each year to reflect the cost of living. The initial dollar amounts may be adjusted in 2022 if there are significant increases in the cost of health care between 2010 and 2022, and may also be increased by an age and gender adjustment in 2022 and later calendar years. The 2016 federal budget requires a study to be conducted on the age and gender adjustment.

In Notice 2015-16, the IRS is considering an approach to clarify the application of the dollar limit for employees with both self-only and other-than-self-only applicable coverage (for example, self-only major medical coverage and supplemental coverage, such as an HRA, that covers the employee and his or her family). The IRS invited comments on the following potential approaches, including any potential administrative difficulties, as well as any other approaches that might address this issue:

- Under one approach, the applicable dollar limit would depend on whether the employee’s primary (major medical) coverage is self-only coverage or other-than-self-only coverage. The employee’s primary coverage would be the type of coverage that accounts for the majority of the aggregate cost of applicable coverage.
- An alternative approach would apply a composite dollar limit determined by prorating the dollar limits for each employee according to the ratio of the cost of the self-only coverage and the cost of the other-than-self-only coverage provided to the employee.

According to Notice 2015-52, to establish the age and gender characteristics of the national workforce for purposes of the age and gender adjustment, the IRS is considering using the Current Population Survey for this purpose, as summarized in Table A-8a, Employed Persons and Employment-Population Ratios by Age and Sex, Seasonally Adjusted (Table A-8a), published annually by the Department of Labor (DOL) Bureau of Labor Statistics (BLS).

To determine the age and gender characteristics of a particular employer’s population, the IRS is considering a requirement that an employer use the first day of the plan year as a snapshot date for determining the composition of its employee population. The IRS anticipates that it will publish adjustment tables to facilitate the calculation of the age and gender adjustment. A specific seven-step approach is being considered for the development of these tables and the calculation of the age and gender adjustment.

## **PASSING THE COST OF THE CADILLAC TAX ON TO THE EMPLOYER**

In some cases, the IRS anticipates that all or part of the Cadillac tax amount may be passed through to the employer. If the coverage provider does pass through and receive reimbursement for the tax, **the**



**excise tax reimbursement will be additional taxable income to the coverage provider.** As a result, the IRS expects that the amount the coverage provider passes through to the employer may include both:

- The excise tax reimbursement; and
- The amount of the additional income tax (the income tax reimbursement).

The ACA provides that any Cadillac tax amount owed may not be taken into account in determining the cost of applicable coverage subject to the excise tax. According to the IRS, this indicates that the excise tax reimbursement should be excluded from the cost of applicable coverage, and it is anticipated that future regulations will reflect this interpretation.

The IRS is also considering whether some or all of the income tax reimbursement could be excluded from the cost of applicable coverage. Because it may not be feasible to exclude amounts that are not separately billed, the IRS anticipates that coverage providers would be permitted to exclude the amount of any excise tax reimbursement or income tax reimbursement **only if it is separately billed and identified as attributable to the cost of the excise tax.**

The 2016 federal budget removed the provision in the ACA that provided that the Cadillac tax was not deductible as a business expense. Because this provision was removed, **the Cadillac tax, once enacted, will now be deductible.** This means insurers may not have to pass on any additional amount to employers beyond reimbursement for the Cadillac tax amount.

## **NOTICE AND PAYMENT**

The IRS is considering both the form in which the employer must notify the various coverage providers and the IRS of any Cadillac tax due, and the time at which that information must be provided. The IRS is also considering how calculation errors that affect the cost of applicable coverage could affect multiple coverage providers and how instances of reallocation might be mitigated or avoided.

The ACA does not specify the time and manner in which the excise tax is paid by the coverage provider. The IRS is considering designating the filing of Form 720, the Quarterly Federal Excise Tax Return, as the appropriate method for the payment of the tax. Although Form 720 is generally filed quarterly, under this approach, a particular quarter of the calendar year would be designated for the use of Form 720 to pay the Cadillac tax.

## **IRS NOTICE 2015-16 AND NOTICE 2015-52**

The IRS invited comments on the issues addressed in Notices 2015-16 and 2015-52, and on any other issues under the Cadillac tax provision. Comments were due in 2015, and are expected to be used to draft proposed regulations. **Taxpayers may not rely upon Notice 2015-16 or Notice 2015-52 for guidance regarding the Cadillac tax provision.** The IRS also specified that no inference should be drawn from the notice concerning any provision of Section 49801 other than those addressed in the notice or concerning any other section of the ACA or COBRA.

## PENALTIES

If the employer or plan sponsor fails to accurately calculate the excess benefit attributable to each coverage provider, and as a result the coverage provider pays too little tax, the employer or plan sponsor will be subject to a tax penalty. The coverage provider will not be assessed any penalty, but will be required to pay the amount of the additional tax.

Although the multiemployer plan sponsor must calculate and report the excise tax amount for a multiemployer plan, the statute specifically requires the **employer** or **plan sponsor** to pay any penalty owed for miscalculating the tax. As a result, it is uncertain whether the employers who provide coverage through a multiemployer plan may be responsible for the penalty, even though they are not responsible for calculating the amount of the tax.

The penalty amount is:

- 100 percent of the additional excise tax due; and
- Interest on the underpayment.

The penalty will not apply if the employer or plan sponsor can establish that it did not know, and could not have known through reasonable diligence, that the failure existed. In addition, a penalty will not apply if the failure was due to reasonable cause and not willful neglect, so long as:

- It is corrected within 30 days after the employer (or plan sponsor) knew or, through reasonable diligence, would have known, that the failure existed; or
- The IRS waives all or any portion of the penalty.