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"Cadillac" Tax on High-cost Health Coverage

For taxable years beginning in 2018, the Affordable Care Act (ACA) imposes a 40 percent excise tax on high-cost group health coverage. This tax, also known as the "Cadillac tax," is intended to encourage companies to choose lower-cost health plans for their employees. Found in Internal Revenue Code (Code) section 49801, the Cadillac tax provision 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 amount for each employee's coverage will be calculated by the employer and paid by the coverage provider who provided the coverage.

The Internal Revenue Service (IRS) is expected to issue guidance on the Cadillac tax requirements before they become effective in 2018.

TYPES OF COVERAGE SUBJECT TO THE 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. The term "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.

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.

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. For example:

If Coverage Is:	The Coverage Provider Is:
Health Insurance Coverage	The health insurance issuer
HSA or Archer MSA Contributions	The employer
Other coverage	The person that administers the plan benefits (This includes the plan sponsor, if the plan sponsor administers benefits under the plan. However, no other guidance has been issued to better define this term.)

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.

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 it may be shorter. Future guidance may also specify different taxable periods for employers of varying sizes.

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.

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4/13; BK 5/14

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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 other than individual 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 that may be 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
The cost of the health FSA coverage is the sum of the **employee's salary reduction contributions** plus the cost of any **reimbursement in excess** of the employee's salary reduction contributions. 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.	The cost of the HSA or Archer MSA coverage is the amount of the **employer's contributions**. 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. Other contributions, such as employee contributions made outside a cafeteria plan, will not be counted toward the cost of coverage.

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** (defined as 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 or install electrical or 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);

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4/13; BK 5/14

- 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 2018 if there are significant increases in the cost of health care between 2010 and 2018, and may also be increased by an age and gender adjustment in 2018 and later calendar years.

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.

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4/13; BK 5/14