It's time to start thinking about

By David Leo, President of WMI® Mutual Insurance Company & WMI TPA®

One of the most significant, yet controversial provisions of the Affordable Care Act (the ACA or Obamacare) is the 40% excise tax on high-cost health coverage. This permanent tax, commonly referred to as the "Cadillac tax," is effective in taxable years beginning after 2017. It will be levied on the amount, if any, by which the monthly cost of an employee's employer-sponsored health insurance coverage exceeds the permissible thresholds established by the ACA.

Unlike an income or sales tax, an excise tax is a surcharge on the sale of a particular good. In this case, the excise tax is applied to employer-sponsored health care coverage. To add insult to injury, it's not tax deductible.

For those of you keeping score at home, the current Cadillac tax threshold amounts are $10,200 for self-only coverage and $27,500 for other than self-only coverage. These amounts are based on the total cost of the coverage, they include contributions from the employer and the employee (but not typical cost sharing amounts like deductibles, co-insurance or copayments), and they will be adjusted annually for inflation. While federal regulations allow for small adjustments in addition to the inflationary adjustment, for the most part, any amount of the aggregate cost of the coverage that exceeds the applicable threshold is subject to a 40% tax!

The philosophy behind the Cadillac tax, in addition to raising much needed revenue to offset the exorbitant costs of Obamacare, is that it will scale back the tax-preferred treatment of employer-provided health insurance. In theory, this will reduce the number of Americans with all-inclusive comprehensive health insurance benefits, which will make individuals more personally responsible for the cost of their health care, which will put pressure on providers to keep health care affordable, which will help control the skyrocketing cost of health care, which will help solve our affordability crisis in the U.S. That's the *theory* behind the Cadillac tax. If you ask me, it's akin to pushing a rope.

The Cadillac tax applies to virtually all types of employer-sponsored coverage. There are no exceptions for grandfathered plans, retiree coverage, FSAs, HSAs, MSAs, HRAs or on-site medical clinics. The tax is assessable on a calendar-year basis (a fact that could create a nightmare for employers with plans that are not calendar-year plans or that change insurers or administrators mid-year), and it applies uniformly to all employees regardless of their personal geographic domicile.

Some of the most vexing questions about the Cadillac tax involve the law's most basic details (*e.g.*, how a plan's value will be calculated, who will be responsible for paying the tax, whether the criteria for the Cadillac tax will disproportionally and inequitably affect older Americans or those who happen to live in higher-cost geographic areas). In response to the IRS's recent publication about the Cadillac tax (IRS Notice 2015-52), America's Health Insurance Plans (AHIP), a national trade association that represents the health insurance industry, identified several of these problems and offered various common sense solutions. Since Washington, DC and common sense generally don't mix, it remains to be seen whether AHIP's suggestions will be adopted. Nonetheless, here are a few of the more pressing Cadillac tax issues and practical proposals for addressing them.

- In general, a plan's value is determined the same way COBRA premium is calculated (*i.e.*, it is the cost for similarly situated beneficiaries who are actively covered under the plan, regardless of whether that cost is paid by the employer or the employee). This can create huge disparities in premium costs for older employees who generally pay three times more than what younger employees pay for the exact same coverage. It can also create disparities in premium for those living in high-cost medical areas, since they are often charged more than those living in low-cost areas. Although the federal regulations allow threshold adjustments for age, they don't allow for adjustments that take into consideration the high costs associated with geography.

~ Obamacare Cadillac Tax!

In other words, it's quite likely that employees in high-cost metropolitan areas will fall victim to the Cadillac tax, while employees with the exact same plan in lower-cost rural areas will not, merely because it costs more to provide the benefits in the higher cost areas. AHIP proposes the IRS develop simplified procedures for health insurers and employers to make appropriate age and geographic adjustments to the benchmark premium amounts to "undo" any inequities that may otherwise occur.

- Ironically, if an employer complies with the ACA's "play or pay" mandate and covers employees on an ACA-compliant bronze plan (the cheapest plan with acceptable ACA coverage), but the cost of that coverage happens to exceed the applicable threshold amount (perhaps due to factors like age and geography), the employer will be subject to the 40% excise tax. AHIP proposes a "safe harbor" for employers who purchase ACA-compliant bronze plans to shield them from Cadillac tax liability.
- According to section 4980I(c)(2) of the Internal Revenue Code (as enacted by the ACA), if the coverage is provided through an insurance company (as opposed to a self-funded plan), the health insurance company that provides the insurance is responsible for paying the excise tax. If the employer makes contributions to health savings accounts (HSAs) or Archer MSAs, the employer is liable for the excise tax. In the case of any other applicable employer-sponsored coverage, the party liable for the tax is "the person that administers the plan benefits" (*see*, 26 USC §4980I(c)(2)). It's unclear whether the word "person" refers to an independent third party administrator (TPA) or to the employer that sponsors the plan, but AHIP recommends it should be the health plan sponsor (*i.e.*, the employer).
- If insurance companies (and possibly independent TPAs) are responsible to pay the Cadillac tax, there's no doubt they will simply pass along those extra charges to the employer. After all, it's employers that choose the benefits (out of the goodness of their hearts I might add), and the insurer's premium rates are developed net of the Cadillac tax. Therefore, in order for the Cadillac tax to be cost neutral to insurers, they will be forced to "gross up" their premiums so they can continue to collect the true cost of the insurance they provide. Moreover, and somewhat circularly, since the additional grossed up amount will probably be taxable to the insurer, they will need to bump the cost up even more so it will be neutral after adjustments for income, premium and revenue taxes. All this begs the question, "If an insurance company grosses up its premium so it can pay the Cadillac tax on behalf of the employer, which figure is used to determine whether the applicable benefit threshold is breached?" Is it the "original value" of the plan that triggers the excise tax, or the "grossed up" cost? Not surprisingly, AHIP suggests the plan sponsor should be designated as the person liable for the excise tax with respect to coverage other than health insurance or contributions to HSAs and Archer MSAs, and that the IRS permit service providers to deduct the excise tax (and any other state and federal taxes and regulatory fees) from the cost of the coverage.

It will be interesting to see whether and how the federal government ultimately resolves these and many other questions surrounding the Cadillac tax. In the meantime, although we are still several years away from Cadillac tax implementation, employers would be wise to examine this ill-conceived tax, and to analyze how it will affect their businesses and benefit plans. If you have any questions, feel free to contact me at *(801) 263-8000* or *davidleo@wmimutual.com*.

As Always ...

If you have questions about this article or would like to discuss your company's insurance program, please feel free to contact WMI. If you would like to learn more about how WMI can meet your company's insurance needs, please contact our Marketing Department at ***(800) 748-5340.*** We would also invite you to visit our website at

www.wmimutual.com

for other interesting articles and helpful information about group health insurance.