MY BENEFIT ADVISOR

Cadillac Tax

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Preliminary Guidance, Part 1

The IRS issued preliminary guidance regarding the excise tax on high cost employer-sponsored health coverage, commonly known as the "Cadillac Tax." Notice 2015-16 describes potential approaches being considered in developing guidance under Section 4980I. Specifically the Notice addresses (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 will seek comments on potential approaches to a number of issues both with respect to this Notice and a subsequent notice that is expected to address other issues. Additionally, there will be an opportunity to comment after the proposed rule is issued.

The Notice is lengthy and full of complicated details. To simply the information, we will release two articles regarding this information. This first article addresses the definition of applicable coverage.

Background

Beginning January 1, 2018, Code Section 4980I imposes a 40% excise tax on any excess benefit provided to an employee that exceeds prescribed thresholds. An excess benefit is the excess, if any, of the aggregate cost of the applicable coverage of the employee for the month over the applicable dollar limit for the employee for that month. The 2018 thresholds are $10,200 for self-only coverage and $27,500 for coverage other than self-only (these thresholds are annualized and adjusted in certain circumstances). For example, an employee's aggregate cost of applicable coverage for a month is $600. Since she has self-only coverage, the threshold is $850 ($10,200/12). There would be no excise tax because the $600 falls below the $850 threshold. However, if the aggregate cost was $1,000, then a 40% excise tax on $150 applies ($1,000 - $850), totaling $60 for the month.

Applicable Coverage

"Applicable coverage" generally means coverage under a group health plan (insured or self-insured) that is made available to an employee by an employer that is excludable from the employee's income (or would be excludable if it were employer-provided coverage). In determining Cadillac Tax liability, it is important to first determine what health plan benefits are considered applicable coverage. While the Notice provides helpful clarification as to types of benefits potentially impacted by this tax, it also raises a number or questions regarding HSAs, on-site clinics, self-insured dental and vision coverage and EAPs.

Applicable Coverage

- Major medical coverage
- Health FSA
- HSA (employer contributions and pre-tax employee contributions through a cafeteria plan)
- On-site medical clinics
- Coverage for specified disease, illness or hospital indemnity policy when paid by the employer or on a pre-tax basis
- Executive physicals
- HRAs

Not Applicable Coverage

- Many excepted benefits
- Long-term care
- Insured dental and vision (see discussion of self-insured dental and vision)
- Coverage for specified disease, illness or hospital indemnity policy when paid for on an after tax basis
- Employee after tax contributions to an HSA

It is important to note that governmental plans, retiree plans, and multiemployer plans are included as applicable coverage.

Health Savings Accounts

The IRS anticipates that employer contributions to health savings accounts (HSAs) are applicable coverage. This includes pre-tax salary reduction contributions. The cost of the coverage equals the amount of all "employer contributions" (including employee pre-tax salary reductions). While the statute defines HSA contributions as applicable coverage (and the IRS's interpretation appears consistent with that definition), the potential implications of this definition are troubling. Notably:

- While many employers use qualified HDHPs to control cost, the inclusion of employer contributions and employee pre-tax contributions to the HSA associated with this coverage may result in many of these arrangements hitting the excise tax threshold.

For example, if an employee with self-only coverage contributed the maximum HSA contribution amount in 2018 and that amount was $3,500, this would leave only $6,700 for the major medical plan and any of the other "applicable coverages" before an excise tax would apply.

- If these contributions are included as applicable coverage, employers may be discouraged from making contributions to the employee's HSA to avoid exposure to the Cadillac Tax. In addition, should the employer continue to make a contribution to employees' HSAs, the employer likely will become subject to rather stringent comparability rules if pre-tax contributions (through a cafeteria plan) to the HSA account are eliminated in order to reduce potential excise tax liability

- In the event the ability for an employee to make pre-tax salary reduction elections to an HSA is removed, the convenience factor of contributing to the HSA may be lost which may result in employees contributing less to their HSAs.

After-tax contributions made to an HSA are not applicable coverage and will not be included in the calculation of the excise tax. Individuals may take a year-end above-the-line deduction of after-tax HSA contributions made during the calendar year on their personal tax returns. This deduction does not affect the excise tax.

On-site Medical Clinics

Coverage provided through an on-site medical clinic is generally applicable coverage. However, the IRS anticipates that forthcoming guidance will exclude on-site medical clinics that offer only de minimis medical care to employees. De minimis is not defined and the IRS seeks comments in this area. Notable, the IRS references the COBRA regulations which exclude an on-site clinic located on the employer's premises from the definition of a group plan if the health care provided:

1. Consists primarily of first aid that is provided during the employer's working hours for treatment of a health condition, illness, or injury that occurs during those working hours;

2. Is available only to current employees; and

3. Is free of charge to employees who use the facility.

The IRS seeks comments on the treatment of clinics that meet the criteria described in the COBRA regulations as well as clinics that may provide certain services in addition to (or in lieu of) first aid.

While not specifically addressed in the Notice, it is likely that final guidance will include robust on-site clinics in the definition of applicable coverage. Such arrangements that provide a wide array of services beyond first aid and allow employees and their family members to receive services will likely not be considered de minimis.

Dental and Vision Coverage

Insured dental and vision coverages are excluded from the applicable coverage definition and will not be included in the aggregate cost of coverage for purposes of determining excise tax liability. However, it is unclear whether self-insured limited-scope dental and vision coverage are applicable coverage. The regulators may consider excluding self-insured dental and vision benefits that are excepted benefits from applicable coverage, thus excluding the cost of such coverage from the excise tax calculation.

Employee Assistance Programs

Under recently issued regulations, employee assistance programs (EAPs) that meet certain criteria are considered excepted benefits. The IRS is considering excluding excepted EAPs from the definition of applicable coverage. The IRS seeks comments opposing this exclusion.

Unaddressed Benefits

The Notice contains no discussion of certain benefits that may be viewed as applicable coverage, including wellness programs and telemedicine. Further guidance on these benefits would be helpful.

Additional guidance is expected and it is anticipated that the benefits community will be actively voicing comments in response to this Notice.