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Cadillac Tax Would Have a Deep Impact on Employers

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New Rules of the Road

By BOB CUMMINGS

Although many provisions of the Affordable Care Act (ACA) have already been implemented, a few major ones are still to come. None are as far-reaching as the proposed 'Cadillac tax' on employer-sponsored health benefits.

Originally scheduled to take effect in 2018, the Cadillac-tax implementation was recently pushed off to 2020. If implemented, the IRS will impose a 40%, non-deductible excise tax on certain employer-sponsored health benefits that exceed a dollar threshold of $10,200 for an individual and $25,500 for a family. Health-insurance companies and self-insured plan sponsors will have to pay the tax on excess dollar amounts for benefits provided above this threshold. After 2020, the limits are to be adjusted for future changes in the consumer price index.

The thresholds will be increased in certain situations if the majority of covered employees are engaged in specified high-risk professions such as law enforcement and construction, and for group demographics including age and gender. For pre-65 retirees and individuals in high-risk professions, the threshold amounts are currently $11,850 for individual coverage and $30,950 for family coverage.

The Obama administration has stated that the purpose of the tax is to reduce the tax-preferred treatment of employer-provided healthcare benefits and raise revenue to help finance the expansion of subsidized health coverage under the ACA. Most experts believe that, contrary to what the name might imply, the Cadillac tax is going to directly impact the majority of employer-sponsored plans.

Many union plans and municipal plans could be impacted right out of the gate, and employers in high-healthcare-cost states like Massachusetts are going to be hit hard if the law goes into effect in its current form. If you thought your healthcare benefit plans were just a Chevy or a Buick, you are in for a big surprise.

As written, the tax is 40% of the cost of health coverage that exceeds these predetermined threshold amounts. Cost of coverage includes the total contributions paid by both the employer and employees, but not cost-sharing amounts such as deductibles, co-insurance, and co-pays when care is received.

Unfortunately, it's not just the premiums for the employer health plans that are counted toward these thresholds, either. Currently, the Cadillac tax would also include contributions under certain pre-tax, account-based plans such as flexible spending accounts and health-savings accounts or health-reimbursement arrangements, as well as most wellness programs.

The calculation includes any contributions made by the employer or employees pre-tax. Employers are going to be responsible for calculating the total dollar value of benefits for each employee on a month-by-month basis and apportioning this among the benefits providers.

Cadillac-tax payments are not deductible for federal tax purposes. Consider what this might mean for an employer offering a health plan with a flexible spending account (FSA) or health-savings account (HSA) with the average total cost of coverage at $12,000 per year for self-only coverage. A $12,000 individual plan would pay an excise tax of $720 per covered employee: $12,000 – $10,200 = $1,800 above the $10,200 threshold; $1,800 x 40% = $720.

The tax on family coverage could be even higher. A $32,000 value of benefits provided to employees with family coverage would pay an excise tax of $1,800 per covered employee: $32,000 – $27,500 = $4,500 above the $27,500 threshold; $4,500 x 40% = $1,800.

On Feb. 23, 2015, the Internal Revenue Service issued a notice covering a number of issues concerning the Cadillac tax and requested comments on possible approaches that could ultimately be incorporated into proposed regulations. No new regulations have been issued to date.

How are employers responding to these looming changes? Many have yet to digest the impact, but the biggest trend is the migration to high-deductible health plans (HDHPS), and health-savings accounts. Recent statistics show that 60% of employers are contemplating or already have moved to implement new high-deductible health plans with companion HSAs. These HDHP plans have upfront deductibles of at least $1,300 single and $2,600 family and out-of-pocket cost sharing of up to $6,550 for a single and $13,100 for a family in 2016. As compared to traditional health-benefits plans, HDHP plans typically have dramatically lower premiums, as much as 40% lower.

Employees covered under a qualified HDHP plan can contribute (as can the employer) to an HSA either through pre-tax payroll or a direct, tax-deductible contribution to an individually owned tax-preferred accumulation account that can be used to pay for any qualified out-of-pocket health expenses during one’s lifetime with tax free dollars.

While downgrading health benefits to higher upfront deductibles is not the most popular solution for all employees, if paired with a health-savings account including some employer contributions into the HSA, it could be more palatable. This next-generation ‘consumer-directed healthcare’ is forcing consumers to assume more risk and responsibility in how they spend money on healthcare decisions.

While there is a growing movement in Congress and among business groups to repeal or significantly amend the Cadillac tax before it takes effect, we can be certain that no action will be taken until well after the 2016 election. However, given the broad-based impact, this is a topic that will likely stay high on the radar for Congress and our next president.

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