Bernie Lowe & Associates, Inc.
"Beyond the Product"

Health Care Reform Update

IMPORTANT NOTICE REGARDING HEALTHCARE REFORM
Update # 34 **June, 2014**

The 2018 Excise Tax – Details You Should Know

Beginning in 2018, the Patient Protection and Affordable Care Act imposes an excise tax on high-cost health plans. In addition to being a way to raise revenue for the government, the reason for this provision is to reduce the demand for high-cost, or so-called Cadillac plans, where the individual has little out-of-pocket cost. The point? To encourage employers, providers, and consumers to control health costs.

So the tax, in the simplest terms penalizes companies that offer high-end health care plans to their employees.

Still, according to the latest projections from the Congressional Budget Office, the tax is expected to generate roughly $80 billion over the next 10 years. That figure represents a decline of almost 42 percent from the $137 billion in earlier CBO forecasts. Nonetheless, employers and their employees will feel the pain. Companies hoping to avoid the tax are beginning to scale back the more generous health benefits they have traditionally offered.

Below are the details you should know.

How does the Cadillac tax work?

Beginning in 2018, a 40 percent nondeductible excise tax will be imposed on "coverage providers" that provide high-cost health care coverage to the employer's employees. Coverage providers include:

- The health insurer for fully insured plans,
- the employer with respect to self-insured plans, HSA or Archer MSA contributions, and
- in all other cases, the "person that administers the plan."

The tax applies to "applicable employer-sponsored coverage," which is coverage under a group health plan that is:

- made available to an employee by an employer, and
  - is either excludable from gross income under Code Section 106, or
  - would be excludable if it were employer-provided coverage within the meaning of Code Section 106.

The excise tax is imposed on the "excess benefit" provided to the employees. The excess benefit is determined by comparing the cost of the actual coverage provided (calculated using rules similar to those for determining COBRA premiums) that exceeds annual limits. For 2018, the annual limit for employee-only coverage is $10,200 per year and $27,500 per year for coverage other than employee-only (as adjusted by a "health cost adjustment percentage" or HCAP). There is no exception to the tax for grandfathered plans. HCAP takes into account year-to-year increases in the cost of health care coverage, including increases attributable to age and gender differences.

What is the effect on the excise tax if the employee pays for all or part of the coverage?

Whether the employer or the employee pays for coverage does not impact the determination of whether it is "applicable employer-sponsored coverage." However, it can affect the cost of that coverage when the amount of an employee's excess benefit is calculated, which affects the amount of excise tax payable.

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What coverage is not subject to the excise tax?

The value of employer sponsored coverage for long term care and the following benefits described in Code Section 9832(c)(1) that are excepted benefits and exempt from the portability, access and renewability requirements of the Health Insurance Portability and Accountability Act (HIPAA).

In determining whether the value of health coverage exceeds the threshold amount, the following items are not included.

- coverage only for accident or disability income insurance, or any combination of these coverages;
- coverage issued as a supplement to liability insurance;
- liability insurance, including general liability insurance 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.
- The value of independent, non-coordinated coverage described in Code Section 9832(c)(3) if that coverage is purchased exclusively by the employee with after-tax dollars (or, in the case of a self-employed individual, for which a deduction under Code Section 162(l) is not allowable). Such Code Section 9832(c)(3) coverage includes coverage only for a specified disease or illness, as well as hospital indemnity or other fixed indemnity insurance. Fixed indemnity health coverage pays fixed dollar amounts based on the occurrence of qualifying events, including but not limited to the diagnosis of a specific disease, an accidental injury or a hospitalization, and no coordination with other health coverage. The value of employer-sponsored health insurance coverage does include the value of such coverage if any portion of the coverage is employer-provided or, in the case of a self-employed individual, if a deduction is allowable for any portion of the payment for the coverage.
- Any coverage under a separate policy, certificate, or contract of insurance that provides benefits substantially all of which are for treatment of the mouth (including any organ or structure within the mouth) or for treatment of the eye.

Is there any relief in the Cadillac tax rules for people whose health coverage is expensive because their occupation is dangerous?

Yes. The annual limits are increased by $1,650 and $3,450, respectively, for employees in high-risk professions (e.g., law enforcement, EMT/paramedics, construction, mining, longshoremen, and so forth).

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How is the tax calculated?

Liability for the excise tax is determined on a monthly basis. Employers are required to calculate the amount of the excess benefit subject to the excise tax for each taxable period and to determine each coverage provider's "applicable share" of the excess benefit.

In a case where an employer has multiple coverage providers, a single coverage provider's applicable share of an employee's excess benefit is determined by multiplying the aggregate excess benefit for the employee by the ratio obtained by comparing (i) the cost of the coverage provided to the employee by the coverage provider to (ii) the aggregate cost of all applicable coverage.

The tax is equal to 40 percent of the aggregate excess benefit that exceeds the annual limits. For each employee the aggregate value of the health insurance coverage it is:

1. the sum of the aggregate premiums for health insurance coverage, plus
2. the amount of any salary reduction contributions to a health flexible spending account (FSA) for the tax year, plus
3. the dollar amount of employer contributions to a health savings account (HSA) or an Archer medical savings account (MSA),

The aggregate premiums for health insurance coverage (in 1 above) includes all employer sponsored health insurance coverage including coverage for any supplementary health insurance coverage, including, the applicable premium for health coverage provided through a health reimbursement account (HRA).

What are the annual limits?

For 2018, the annual limit dollar amount is;

1. $10,200 for individual coverage and $27,500 for family coverage, which is
2. multiplied by the health cost adjustment percentage, and
3. increased by the age and gender adjusted excess premium amount.

The health cost adjustment percentage is equal to any amount in excess exceeding 55 percent, of the percentage by which the per employee cost of coverage under the Blue Cross/Blue Shield standard benefit option under the Federal Employees Health Benefits Plan (standard FEHBP coverage) for plan year 2018 exceeds the per employee cost for the plan year 2010. In 2019, the annual limit amounts, after application of the health cost adjustment percentage in 2018, will be indexed to the Consumer Price Index for All Urban Consumers (CPI-U), as determined by the Department of Labor, plus one percentage point, rounded to the nearest $50. In 2020 and thereafter, the threshold amounts are indexed to the CPI-U as determined by the Department of Labor, rounded to the nearest $50.

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For each employee (other than for certain retirees and employees in high-risk professions, whose thresholds are adjusted under rules described below), the age and gender adjusted excess premium amount is equal to the excess, if any, of:

1. the premium cost of standard FEHBP coverage for the type of coverage provided to the individual if priced for the age and gender characteristics of all employees of the individual's employer, over
2. the premium cost, determined under procedures proscribed by IRS, for that coverage if priced for the age and gender characteristics of the national workforce.

However, increased annual limits apply for certain classes of taxpayers. The annual limit amounts are increased for an individual who has attained age 55, is not Medicare eligible, and is receiving employer-sponsored retiree health coverage, or is covered by a plan sponsored by an employer, the majority of whose employees covered by the plan are engaged in a high-risk profession or employed to repair or install electrical and telecommunications lines. For these individuals, the annual limit amount in 2018 is increased by:

1. $1,650 for individual coverage or $3,450 for family coverage, and
2. the age and gender-adjusted excess premium amount.

In 2019, the primary threshold amounts and additional $1,650 and $3,450 amounts are indexed to the CPI-U, plus one percentage point, rounded to the nearest $50. In 2020 and thereafter, the additional threshold amounts are indexed to the CPI-U, rounded to the nearest $50.

Who pays the excise tax and how it is allocated?

For insured coverage, the excise tax is allocated pro rata among the insurers providing coverage to the employer, with each insurer responsible for payment of the excise tax on an amount equal to the amount subject to the total excise tax multiplied by a fraction, having as the numerator the amount of employer-sponsored health insurance coverage provided by that insurer to the employer and having as the denominator the aggregate value of all employer-sponsored health insurance coverage provided to the employer. It is assumed the insurer will pass the cost back to the employer through premium.

For a self-insured group health plan, a health FSA or an HRA, the excise tax is paid by the entity that administers benefits under the plan or arrangement (the "plan administrator"). The excise tax is paid by the employer if it acts as plan administrator to a self-insured group health plan, a health FSA or an HRA. Where an employer contributes to an HSA or an Archer MSA, the employer is responsible for payment of the excise tax, as the insurer.

The employer is responsible for calculating the amount subject to the excise tax that will be allocated to each insurer and plan administrator and for reporting these amounts to each insurer, plan administrator and IRS, in the form and at the time that IRS may set. Each insurer and plan administrator is then responsible for calculating, reporting, and paying the excise tax to IRS on such forms and at such time as IRS may set.

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What is the sanction on the employer for underreporting liability for the tax?

Example: In 2018, an employee elects family coverage under a fully insured healthcare policy covering major medical and dental with a value of $32,000. The health cost adjustment percentage for that year is 100 percent, and the age and gender adjusted excess premium amount for the employee is $600. On these facts, the amount subject to the excise tax is $3,900 ($32,000 less the threshold of $28,100, which is the $27,500 threshold multiplied by 100 percent and increased by $600.) The employer reports $3,900 as taxable to the insurer, which calculates and remits the excise tax of $1,560 (40 percent of 3900) to the IRS.

A penalty will apply to any employer who reports (to insurers, plan administrators and the IRS) an insurance cost subject to the excise tax that is lower than required. The penalty is the sum of any additional excise tax that each such insurer and administrator would have owed if the employer had reported correctly plus interest attributable to that additional excise tax from the date that the tax was otherwise due to the date paid by the employer.

The penalty does not apply if it is established to IRS's satisfaction that the employer neither knew, nor by exercising reasonable diligence would have known, that the failure existed. In addition, no penalty will be imposed on any failure corrected within the thirty-day period beginning on the first date that the employer knew, or exercising reasonable diligence, would have known, that the failure existed, so long as the failure is due to reasonable cause and not to willful neglect. All or part of the penalty may be waived by IRS in the case of any failure due to reasonable cause and not to willful neglect, to the extent that the payment of the penalty would be excessive or otherwise inequitable relative to the failure involved.