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HEALTH CARE REFORM

## Eye on Washington

# TREASURY ISSUES INITIAL GUIDANCE ON “CADILLAC” TAX

On February 23, 2015, the U.S. Department of Treasury and the Internal Revenue Service (together, Treasury) released Notice 2015-16 (the Notice), which is the initial guidance on the Affordable Care Act’s Excise Tax on high-cost health coverage, informally known as the “Cadillac Tax.” The Notice addresses which plans are subject to the high-cost plan Excise Tax, how to determine the cost of coverage, and how to apply the statutory dollar limit to the cost of coverage. However, the Notice does not address other open issues, including how an employer should allocate the Excise Tax to various entities. Below we summarize key issues discussed in the Notice.

### Background on Excise Tax

Beginning in 2018, Section 4980I of the Internal Revenue Code (Code) will impose a 40% Excise Tax on employers, health insurers, and/or plan administrators if the aggregate value of employer-sponsored coverage for an employee, former employee, surviving spouse, or other primary insured individual exceeds a threshold limit. Coverage is only subject to the tax if it is “applicable employer-sponsored coverage,” which generally means coverage under a group health plan made available by an employer that is (1) excludable from income under Code Section 106, or (2) would be excludable if it were employer-provided coverage. It includes both the employer- and employee-paid portions of coverage, regardless of whether such amounts are paid on a pre- or post-tax basis.

The “aggregate cost” of all applicable employer-sponsored coverage is generally calculated under rules similar to the rules for determining applicable premiums under the COBRA continuation coverage rules. In order for the tax to apply, the aggregate cost of all applicable employer-sponsored coverage in which an employee is enrolled must exceed a threshold amount. For 2018, the threshold amount is \$10,200 for individual coverage and \$27,500 for family coverage (with certain adjustments for inflation, age, gender, qualified retirees, multiemployer plans, and high-risk professions).

The employer is responsible for calculating the amount subject to the Excise Tax allocable to each insurer and plan

administrator – and for reporting these amounts to each insurer, plan administrator and the Treasury, in a form and time to be determined. Each insurer and plan administrator will then be responsible for paying the Excise Tax.

However, the statute provides that if an employer does not accurately report excess benefit amounts to coverage providers, the employer is liable for a penalty of 100% of any Excise Tax underpayment, plus interest. This provision is intended to establish a strong incentive for employers to accurately report excess benefit amounts.

### Coverage Subject to Excise Tax

The Notice provides the following guidance about coverage subject to the Excise Tax:

- **HSAs and Archer MSAs** – Future proposed regulations will provide that (1) employer contributions to Health Savings Accounts (HSAs) and Archer Medical Savings Accounts (MSAs), including salary reduction contributions to HSAs, are included in applicable coverage, and (2) employee after-tax contributions to HSAs and Archer MSAs are excluded from applicable coverage.
- **On-Site Medical Clinics** – Treasury anticipates that the forthcoming proposed regulations will provide that applicable coverage does not include on-site medical clinics that offer only *de minimis* medical care to employees.



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- **Limited-Scope Dental and Vision** – Treasury is considering whether to exclude self-insured, limited-scope dental and vision coverage that qualifies as an excepted benefit from applicable coverage. (Insured, stand-alone vision and dental plans are specifically excluded in the statutory language.)
- **EAPs** – Treasury is considering whether to propose that Employee Assistance Programs (EAPs) that qualify as an excepted benefit would be excluded from applicable coverage.
- **Executive Physical Programs** – Executive physical programs are expected to constitute applicable coverage under future regulations.
- **Coverage of Members of the Military** – Treasury states that the statute “implies” that coverage provided under a plan maintained for members of the military is not applicable coverage.
- **HRAs** – Treasury refers to the statute in noting that Health Reimbursement Accounts (HRAs) are subject to the Excise Tax under Code Section 4980I.
- **Health FSAs** – The Notice also makes clear that Treasury believes the Excise Tax applies to contributions to health Flexible Spending Accounts (FSAs), whether in the form of employer contributions (i.e., “flex credits”) or pretax salary reduction contributions.

### Determining Costs

The Notice provides the following additional guidance regarding determining the cost of coverage:

- **Cost of Coverage Is Based on Coverage in Which the Employee Is Enrolled** – Treasury clarifies that the applicable coverage compared to the dollar limit for purposes of determining the Excise Tax is the applicable coverage in which the employee is enrolled, rather than the coverage offered.
- **Similarly Situated Individuals** – In order to determine the cost of coverage for employees under rules similar to the COBRA rules, employers will need to know

how to determine the different costs for different groups of “similarly situated employees.” Under the general approach that Treasury is considering, each group of “similarly situated employees” would be determined by starting with all employees covered by a particular benefits package provided by the employer, then subdividing that group based on mandatory disaggregation rules based on whether the employee was enrolled in self-only or other-than-self-only coverage, and allowing further subdivision of the group based on permissive disaggregation rules.

- **Self-Insured Plans** – Treasury indicates that the methods currently prescribed by COBRA for self-insured plans to compute the COBRA applicable premium – the “actuarial basis” method and the “past cost” method – will also apply for determining the cost of applicable coverage for self-insured plans under Code Section 4980I. Treasury is considering proposing a rule (that would apply for both COBRA and Section 4980I purposes) that generally would require a plan to use the valuation method that it chooses for a period of at least five years (with certain exceptions).
- **HRAs** – Treasury is considering various methods that future guidance might permit for use in determining the cost of applicable coverage under an HRA, including basing the determination on the amounts made newly available to a participant each year.

### Dollar Limit

The Excise Tax only applies to the cost of coverage over an applicable dollar limit. The Notice provides the following guidance about the applicable dollar limit:

- **Employees With Both Self-Only and Other-Than-Self-Only Coverage** – Some employees may have coverage to which the self-only dollar limit applies and coverage to which the other-than-self-only dollar limit applies. Treasury is considering an approach under which the applicable dollar limit for an employee would depend on whether the employee’s primary coverage/major



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medical coverage is self-only coverage or other-than-self-only coverage. An alternative approach would apply a composite dollar limit determined by prorating the dollar limits for each employee according to the ratio of the cost of the self-only coverage and the cost of the other-than-self-only coverage provided to the employee.

- **Dollar Limit Adjustments** – Treasury generally indicates that it will provide rules regarding the dollar limit adjustments in future guidance and specifically asks for comments on adjustments for qualified retirees, high-risk professions, and age and gender.

### Possibility of Other Methods to Determine Cost

Although Code Section 4980I appears to require that the cost of coverage be determined under rules similar to the COBRA rules, Treasury notes that some stakeholders have suggested that the cost of applicable coverage could instead be determined by reference to the cost of similar coverage available elsewhere (for example, based on actuarial values, metal levels (e.g., bronze, silver, etc.), or the cost of coverage available in a Marketplace/Exchange). Treasury invites comments on whether any alternative approaches to determining the cost of applicable coverage would be consistent with the statutory requirements of Code Section 4980I and, if so, would be useful.

### Form W-2 Reporting of Applicable Coverage

The Notice discusses the current employer reporting of the aggregate cost of health coverage on Forms W-2, under Code Section 6051(a)(14). This amount is currently reported in Box 12 of the Form W-2, using Code DD. However, as explained in IRS Notice 2012-9, until further guidance is issued, employers are not subject to this reporting requirement if the employer files fewer than 250 Forms W-2 for the preceding calendar year.

There are likely to be differences in the aggregate cost of health coverage subject to the Excise Tax under Code Section 4980I and the amount currently reported on Forms W-2. Treasury anticipates that to the extent guidance under Code Section 4980I provides improved methods for determining the cost of applicable coverage, consistent rules may be issued for purposes of W-2 reporting under Code Section 6051(a)(14).

### Comments Requested

Treasury invites comments on the issues addressed in the Notice and on any other issues involving the Excise Tax. Comments are due by May 15. Treasury intends to issue another notice that will address other issues, including the calculation and assessment of the tax, before publishing proposed regulations.

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