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View From Groom: Cadillac Tax – What Can We Expect in the Second Notice?



BY RACHEL LEISER LEVY

On February 23, 2015 Treasury and the Internal Revenue Service (“IRS”) issued Notice 2015-16 (“first Notice”), their opening salvo in what may come to be called the Cadillac Tax Wars by future generations of benefits lawyers. In the words of Treasury and the IRS, Notice 2015-16 was intended to “initiate and inform the process of developing regulatory guidance regarding the excise tax. . .” In addition to sketching out Treasury and the IRS’s contemplated approaches to several issues arising under the excise tax on high cost employer-sponsored health coverage, Notice 2015-16 promised a second notice prior to the issuance of proposed regulations.

Now that several months have passed since publication of Notice 2015-16 it is time to turn attention to what Treasury and the IRS may include in the promised second notice. Based on informal comments from Treasury and IRS officials it seems likely that a second notice will be issued by the end of the summer, if not sooner. Below are five issues that it would be helpful for Treasury and IRS to address in the upcoming second notice.

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Background

The Affordable Care Act (“ACA”) added section 4980I to the Internal Revenue Code (“Code”). Section 4980I imposes an excise tax on certain high cost employer-sponsored health coverage (commonly referred to as the Cadillac Tax) (“Excise Tax” or “Tax”). Generally, under Section 4980I, if the aggregate cost of applicable coverage provided to an employee exceeds a statutory dollar limit, the excess amount is subject to a 40% excise tax.

Section 4980I provides that the cost of applicable coverage is to be determined under rules similar to those used for determining the cost of COBRA coverage. As with determinations made under the individual and employer shared responsibility provisions, the cost of coverage is looked at on a monthly, and not an annual, basis. Applicable coverage is generally coverage under a group health plan offered by an employer that is excludable from an employee’s gross income (or would be excludable if it were employer-provided coverage, so also including coverage paid for by an employee with after-tax dollars). The Excise Tax applies to applicable coverage provided to former employees (including retirees), surviving spouses, and other primary insureds, as well as coverage provided to employees.

The statutory dollar limits for 2018 are \$10,200 for self-only coverage and \$27,500 for other-than-self-only coverage (these amounts will be increased in 2018 if the actual growth in the cost of the Blue Cross/Blue Shield standard benefit option under the Federal Employees Health Benefits Plan between plan year 2010 and plan year 2018 exceeds 55%). Beginning in 2019, the dollar limits will be subject to annual cost-of-living adjustments. For 2018 and later, the dollar limits are also in-

creased in certain circumstances, including for age and gender, for participants in a plan in which the majority of employees covered are either engaged in a high risk profession (specifically listed in the statute) or employed to repair or install electrical and telecommunications lines, and for certain qualified retirees.

Liability for the Excise Tax is based on the type of applicable coverage offered. Health insurance issuers pay if the Tax is assessed against an insured plan, employers pay if the Tax is assessed against coverage consisting of employer contributions to an HSA or an Archer MSA, and “the person that administers the plan” pays the Tax if it is assessed against any other type of coverage. It is always the employer’s obligation to calculate the amount of the Tax and notify the liable entity.

Any Excise Tax paid is not deductible for federal tax purposes.

The Tax is effective for taxable years beginning after December 31, 2017.

The First Notice

Notice 2015-16 provided some statutory background on the Excise Tax and described potential approaches to the following three issues: (1) the definition of applicable coverage; (2) determination of the cost of applicable coverage; and (3) application of the annual statutory dollar limits to the cost of applicable coverage. The first Notice also requested comments on the potential approaches as well as comments on the Excise Tax as a whole. More than 250 comments were submitted to the IRS prior to the deadline of May 15, 2015.

Notice 2015-16 did not address any of the administrative or procedural issue arising under the Excise Tax.

The Second Notice

In Notice 2015-16 Treasury and the IRS stated that they anticipate issuing a second notice before the publication of proposed regulations under section 4980I. The second notice is expected to describe potential approaches to issues not described in the first Notice, including procedural issues relating to the calculation and assessment of the Excise Tax. Treasury and the IRS are also expected to request comments on the issues addressed in the second notice, as they did on issues addressed in Notice 2015-16.

It seems reasonable to expect that the second notice will focus primarily on administrative and procedural issues arising from the implementation of the Excise Tax.

Below are five issues that it would be helpful for IRS and Treasury to address in the second notice.

1. Payment — Who is liable to pay the Excise Tax for self-insured plans?

2. Timing — What will be the timeframe for calculating the Excise Tax and reporting the information to coverage providers?

3. Exclusion — How will the amount of the Tax be excluded from the cost of coverage, and how should the cost attributable to the Excise Tax be determined?

4. Collision between the Cadillac Tax and the Employer Mandate – What will happen when any minimum

value plan offered by an employer costs more than is permitted under section 4980I?

5. Non-calendar year plans — How will the Excise Tax be administered for non-calendar year plans?

1. Payment: Person That Administers the Plan Benefits

Although it is the employer that is tasked with calculating the amount of any Excise Tax owed and notifying the appropriate parties of the amount of the Excise Tax for which they are responsible, it is not always the employer that is liable for payment of the Excise Tax itself. Rather, Section 4980I provides that insurers are responsible for any amount of the Tax that is associated with a group health plan that provides health insurance coverage, employers are responsible for amounts associated with contributions to an HSA or MSA, and “the person that administers the plan benefits” is responsible for amounts attributable to any other coverage. Neither the statute nor Notice 2015-16 provides a definition of “person that administers the plan benefits.”

Although Treasury and the IRS have not indicated how they plan on defining the term “person that administers the plan benefits” it seems reasonable to assume that either the third party administrator (“TPA”) or the ERISA plan sponsor will be the responsible party. Which of these two entities is determined to be the person that administers plan benefits will be important for both tax administration and tax policy.

Of primary concern of course is simply defining which party is liable for the Tax so that employers can notify the correct party and that party can then remit the correct amount to the IRS. Whether the responsible party is the TPA or the ERISA plan sponsor will probably not matter much for purposes of Tax administration. The effective rate of the tax, however, might be quite different depending on which party is determined to be responsible.

If the TPA is responsible for the Excise Tax, it will presumably charge its client (the employer) in order to recoup its costs. Under generally applicable principles of taxation, that additional amount charged will most likely be treated as income and subject to tax, thus increasing the actual cost of the Excise Tax (either to the TPA which will need to pay additional income tax or to the employer if the TPA requires it to gross up the additional amount paid). If, alternatively, it is the ERISA plan sponsor that is liable for the Tax, the plan sponsor (which is generally the employer) will not need to take any additional amount into income outside of increased premium costs. As noted above, the Excise Tax will not be deductible.

2. Timing and Other Administrative Issues

Section 4980I(c)(4) generally provides that the employer is responsible for calculating the amount subject to the Excise Tax, calculating the applicable share of the Excise Tax that each coverage provider owes, and notifying the IRS and each provider of the results of the calculations. For multiemployer plans, the plan sponsor is responsible for the calculations and the notice.

The statute does not provide any indication of timing or other procedural and administrative issues inherent in a system, such as that set up by Congress in section

4980I, where different parties are responsible for calculating and paying a single tax. For example, decisions about plan terms and coverage are necessarily decided well in advance of the coverage year and insurers will require information from employers in order to be able to structure their plans in such a way as to avoid the Excise Tax. This is especially true given that the cost of all coverage will be aggregated for purposes of the Excise Tax. Insurance providers, and TPAs if applicable, may well find themselves subject to the Tax despite the fact that their products standing alone would not be above the threshold. Liability issues will also be a concern for insurance providers and other parties in the event that an employer errs in calculating the Tax.

Treasury and IRS will need to issue rules, most likely complex, in order to create a system for administering the Excise Tax that permits all parties involved to appropriately plan for and pay the Tax.

3. Excluding the Excise Tax from the Cost of Coverage

Section 4980I(d)(2)(A) states that in determining the cost of coverage for purposes of calculating the Excise Tax “any portion of the cost of such coverage which is attributable to the tax imposed under this section shall not be taken into account.” Presumably, any party that is subject to the Excise Tax will attempt to recoup its costs from its clients. Guidance will be needed on how a party that is responsible for the Excise Tax can determine which costs are “attributable” to the tax and which are not. For example, if potential tax liabilities are included in the cost of premiums, will the added expense be included or excluded when determining the cost of coverage?

Similar issues arise in the context of the deductibility of the Excise Tax. Section 4980I(f)(10) provides that the Excise Tax is not deductible for purposes of federal income tax. Guidance will need to address, however, whether the non-deductibility of the Excise Tax should be considered when determining the cost of the Tax that is excluded from the cost of coverage.

How Treasury and the IRS choose to implement this provision can have profound effects on the amount of tax that will be owed by various parties. As a general rule, the more that costs can be excluded from the cost of coverage, the lower the amount that any party will need to pay. Hopefully, Treasury and the IRS will issue guidance that does not place either insured plans or self-insured plans at a competitive advantage or disadvantage.

4. The Cadillac Tax vs. The Employer Mandate

Under the Employer Shared Responsibility provisions of the ACA, employers must offer affordable minimum value plans to full-time employees and their dependents in order to avoid any potential employer shared responsibility payments. Employers and insurance providers have expressed concern that at some point in the not-too-distant future, and perhaps as early

as the 2020s, any employer-provided plan that meets the minimum value requirements will violate the provisions of 4980I and thus incur the Excise Tax.

Despite all of the difficulties inherent in trying to determine Congressional intent, especially with respect to the ACA which has no real legislative history, it is hard to imagine that the statutory drafters intended such a result. It would appear to violate basic principles of tax equity to force an entity to either pay one punitive tax or another with no way out. If, however, Treasury and IRS do not issue guidance that is exactly the result that will ensue: If an employer satisfies minimum value it will need to pay the Excise Tax and if it wishes to avoid the Excise Tax it will either need to pay a penalty under 4980H(a) for failing to offer coverage at all or under 4980H(b) for failing to offer minimum value coverage. This would result in a pay-or-pay regime rather than the pay-or-play system that Congress intended. Guidance will be required to address this issue well in advance of the time at which it will begin to impact employers and issuers.

5. Non-Calendar Year Plans

Pursuant to section 4980I(f)(8) the Excise Tax will apply on a calendar year basis, or such shorter time periods as Treasury and the IRS may prescribe. Guidance is needed with respect to calculating and paying the Excise Tax for non-calendar-year plans.

What to Expect Next

Over 250 comments were submitted in response to Notice 2015-16 and it is possible that Treasury and the IRS may respond to some of the issues raised in those comments in the second notice. Similarly, Treasury and the IRS could choose to issue a third notice responding to comments submitted in response to the second notice. Given the ever shrinking resources at Treasury and the IRS’ disposal, however, it seems more likely that the comments to both notices will be addressed in forthcoming proposed regulations rather than in a series of notices (such as we saw in the promulgation of the employer shared responsibility rules, for example). Notices take time and resources away from other projects and given that the Tax is effective in 2018 it seems reasonable to expect that once the second notice is out as many resources as possible will be devoted to issuing proposed regulations by the end of 2015. If proposed regulations slip much into 2016, it may be difficult for Treasury and IRS to both allow enough time for detailed comments on the proposed regulations and for the issuance of final regulations with enough time for insurers and employers to set up compliant plans for the 2018 plan year. As a result, at this point it seems reasonable to expect the second notice by the end of the summer, proposed regulations by the end of 2015 or the beginning of 2016, and final regulations close to the end of 2016.

Efforts continue on Capitol Hill to repeal or substantially amend the Excise Tax. With the Excise Tax projected to raise nearly eighty billion dollars in the budget window, however, repeal will likely be difficult.