



## CHEIRON HEALTH ALERT

### *Additional Excise Tax, i.e., “Cadillac Tax” Notice Requests Comments*

September 9, 2015

On July 30, 2015, the Department of the Treasury (Treasury) and the Internal Revenue Service (IRS) released Notice 2015-52 to continue the process of developing regulatory guidance regarding the excise tax on high cost employer-sponsored health coverage (popularly known as the “Cadillac Tax”). The Cadillac Tax applies to taxable years beginning after December 31, 2017.

Previously, on February 23, 2015, the Treasury and IRS released Notice 2015-16 to start the process of developing regulations. The Cheiron Health Alert (dated March 13, 2015) reviewed the issues, definitions, and computation methods addressed in Notice 2015-16. See [https://cheiron.us/articles/Cheiron%20Health%20Alert\\_Cadillac%20Tax%20Notice%20Requests%20Comments\\_2015-03-13.pdf](https://cheiron.us/articles/Cheiron%20Health%20Alert_Cadillac%20Tax%20Notice%20Requests%20Comments_2015-03-13.pdf).

The recently issued Notice 2015-52 supplements Notice 2015-16 by requesting comments on proposed methods to handle issues such as: (i) identification of the taxpayers who may be liable for the excise tax, (ii) employer aggregation, (iii) allocation of the tax among the applicable taxpayers, (iv) payment timing of the applicable tax. A copy of Notice 2015-52 is found at <http://www.irs.gov/pub/irs-drop/n-15-52.pdf>.

Notice 2015-52 explicitly states that the notice “**does not provide guidance under § 4980I upon which taxpayers may rely.**” (See Section VIII; Notice 2015-52)

**Action Needed Now:** Plan sponsors need to consider whether they want to submit comments. All comments should include a reference to Notice 2015-52 and are due **October 1, 2015**.

#### **WHERE TO SEND COMMENTS**

- *Via mail to:* CC:PA:LPD:PR (Notice 2015-52), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044.
- *Via hand-delivery:* Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:LPD:PR (Notice 2015-52), Courier’s Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC 20044.
- *Via email to:* Notice.comments@irsounsel.treas.gov. with “Notice 2015-52” in the subject line.

All submitted material will be available for public inspection and copying.

#### **BACKGROUND/OVERVIEW**

Section 4980I of the Internal Revenue Code was added by the Affordable Care Act (ACA), and applies a 40% excise tax if the cost of “applicable employer-sponsored coverage,” referred to as “applicable coverage,” exceeds a statutory dollar limit. The tax applies to the excess portion of the cost of applicable coverage above the statutory dollar limit. For calendar year 2018, the annual dollar limit (which will be revised annually) for self-only coverage is \$10,200 and for “other-than-self” coverage is \$27,500. Adjustments to the dollar limits are allowable in certain circumstances, such as for: retirees ages 55 through age 64 not on Medicare, high-risk professions, and demographics differing from the national average. In addition, all coverage under a multiemployer plan is treated as other-than-self-only coverage.



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| <b>Cost of Applicable Coverage (AC) (cont.)</b>         | <ul style="list-style-type: none"> <li>■ <b>Cost of Applicable Coverage under FSAs</b> <ul style="list-style-type: none"> <li>▪ Per the statute, the cost of FSA is the greater of an employee's FSA contribution (via salary reduction) or the total reimbursements under the FSA. For example, if an employee puts \$1,000 in the FSA and the employer puts in \$500, but the employee only has \$1,200 in expenses used, only \$1,200 would count toward the Cadillac tax.</li> <li>▪ <u>Without Employer Flex Credits</u> - To avoid the double counting of employee FSA contributions that are carried over to another year (<i>i.e.</i>, taking them into account in both years), the Notice proposes a safe harbor under which the cost of AC for a plan year would be the amount of an employee's FSA contribution without regard to carry-over amounts. Unused amounts carried forward would be disregarded when used to reimburse expenses in a later year.</li> <li>▪ <u>With Employer Flex Credits</u> - A similar safe harbor is under consideration where flex credits are available under a cafeteria plan that includes an FSA where amounts up to the maximum employee FSA contribution (\$2,550 for 2016) would count as employee contributions.</li> </ul> </li> </ul> | <p><b>10 - 12</b></p> |
|   | <ul style="list-style-type: none"> <li>■ <b>Inclusion in Applicable Coverage of Self-Insured Coverage Includible in Income under § 105(h)</b> <ul style="list-style-type: none"> <li>▪ The cost of AC includes excess reimbursements to highly compensated individuals in a discriminatory self-insured plan, even though those amounts are not currently included in the aggregate cost of AC reported on Form W-2. Treasury and IRS anticipate modifying the W-2 reporting rules to reflect this.</li> </ul> </li> </ul>  | <p><b>12 - 13</b></p> |
| <b>4. Age and Gender Adjustment To The Dollar Limit</b> | <ul style="list-style-type: none"> <li>■ <b>Determination of age and gender distribution</b><br/> National workforce - The Notice proposes using the Current Population Survey as summarized in Table A-8a, Employed Persons and Employment-Population Ratios by Age and Sex, Seasonally Adjusted (Table A-8a), published annually by the Department of Labor Bureau of Labor Statistics to determine the age and gender distribution of the national workforce. See <a href="http://www.bls.gov/web/empsit/cpseea08a.htm">http://www.bls.gov/web/empsit/cpseea08a.htm</a>.<br/> Employer's population - To determine the age and gender characteristics of a particular employer's population, the Notice proposes that an employer use the first day of the plan year as a snapshot date for determining the composition of its employee population.</li> </ul>   | <p><b>13 - 14</b></p> |
|   | <ul style="list-style-type: none"> <li>■ <b>Development of Age and Gender Adjustment Tables</b> <ul style="list-style-type: none"> <li>▪ A seven-step approach is proposed for the development of adjustment tables to facilitate and simplify the calculation of the age and gender adjustment. (See Table 2, below.)</li> <li>▪ Two alternative methods are proposed for the determination of average cost for each age and gender group: (i) reliance on actual claims data from the Federal Employees Health Benefits Plan (FEHBP) standard option, or (ii) reliance on national claims data reflecting plans with a design similar to that of the FEHBP standard option.</li> <li>▪ All adjustments and calculations would be determined separately for self-only coverage and for other than self-only coverage.</li> </ul> </li> </ul>   | <p><b>14 - 15</b></p> |

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| 5. Notice and Payment | <ul style="list-style-type: none"> <li>■ <b>Notice of Calculation of Applicable Share of Excess Benefit</b> <ul style="list-style-type: none"> <li>▪ For each taxable period employers must (i) calculate the amount of the excess benefit subject to the Cadillac Tax and the applicable share of that excess benefit for each coverage provider, and (ii) notify the IRS and each coverage provider of the amount determined for each coverage provider. Treasury and IRS are considering both the form and time for providing such information.</li> </ul> </li> </ul> | 16   |
|                       | <ul style="list-style-type: none"> <li>■ <b>Payment of the § 4980I Excise Tax</b> <ul style="list-style-type: none"> <li>▪ Treasury and IRS are considering designating the filing of Form 720, Quarterly Federal Excise Tax Return, as the appropriate method for the payment of the tax. Although Form 720 generally is filed quarterly, under this approach a particular quarter of the calendar year would be designated for the use of Form 720 to pay the Cadillac Tax (similar to the method for paying the PCORI fee).</li> </ul> </li> </ul>                     | 16   |

**Table 2: Proposed Seven-Step Approach for Age and Gender Adjustment**

| Step | Item Calculated   |
|------|---|
| 1    | <ul style="list-style-type: none"> <li>■ <b>Determination of average cost for FEHBP coverage.</b> The average cost of AC under the FEHBP (FEHBP average cost) is determined by aggregating all claims expenses of the FEHBP standard option and dividing the total by the number of coverage units. Each employee policyholder is a coverage unit.</li> </ul>   |
| 2    | <ul style="list-style-type: none"> <li>■ <b>Determination of average cost for each age and gender group.</b> Claims expense data is separated by gender into male and female coverage units and further separated into multi-year age-bands. The dollar amount of claims for each group is then divided by the number of coverage units in that age and gender group to yield the average cost for that group (group average cost).</li> </ul>  |
| 3    | <ul style="list-style-type: none"> <li>■ <b>Determination of group ratios.</b> Each group average cost is divided by the FEHBP average cost to establish the ratio (group ratio) of the group average cost to the FEHBP average cost. The group ratio is expressed as a fraction or percentage and is determined periodically, but <i>less frequently</i> than annually.</li> </ul>   |
| 4    | <ul style="list-style-type: none"> <li>■ <b>Determination of group premium cost.</b> The group ratio is multiplied by the most recent annual premium cost of the FEHBP standard option to determine the annual premium cost for each age and gender group (group premium cost). The dollar amounts representing each group premium cost then are used to populate the adjustment tables, to be published annually.</li> </ul>   |
| 5    | <ul style="list-style-type: none"> <li>■ <b>Determination of national premium cost.</b> To determine the national premium cost, each group premium cost is multiplied by the fraction of employees in the national workforce who are in that group. The product of each of these calculations is added together to yield the national premium cost. A single dollar amount that will be published annually.</li> </ul>  |
| 6    | <ul style="list-style-type: none"> <li>■ <b>Determination of the employer's premium cost.</b> Each employer would determine the fraction of its employees who are in each age and gender group. The employer would then multiply the group premium cost from the relevant adjustment table (step 4) by the fraction of its employees in each group. The product of each of these calculations would be added together to yield the employer's premium cost, which would be a single dollar amount.</li> </ul> |
| 7    | <ul style="list-style-type: none"> <li>■ <b>Determination of adjustment.</b> The employer's premium cost (step 6) is compared to the national premium cost (step 5). If the employer's premium cost exceeds the national premium cost, the excess dollar amount is added to the dollar limit for that employer to determine the amount of any excess benefit. No adjustment is made if the employer's premium cost is below the national premium cost.</li> </ul>   |

## **SPECIFICALLY REQUESTED COMMENTS**

Throughout the Notice, the IRS and Treasury invite comments on specific topics addressed therein. The following list summarizes the specific comment requests in the Notice.

### ■ **Persons Liable for the Cadillac Tax.** Specifically, the approaches for determining the Person That Administers the Plan

#### 1) **If the Day-to-Day Administration Approach is used:**

- What types of administrative functions should be considered under this approach for determining the person that administers the plan benefits?
- Is the person that administers the plan benefits easily identifiable in most instances under this approach, or is the identity of the person that administers the plan benefits often unclear because, for example, multiple parties perform the relevant functions?
- Are there any other concerns this approach would raise?

#### 2) **If the Ultimate Authority Administration Approach is used:**

- Is the person that administers the plan benefits easy to identify in most circumstances under this approach or are there multiple parties that have ultimate authority or responsibility for the different relevant administrative matters?
- Are there any other issues this approach would raise?

#### 3) **For Collectively Bargained Multiemployer Health Plans:**

- Are there any unique concerns in applying either of these approaches?

***Cheiron comment:** Because the Cadillac Tax is not a deductible expense, the effective rate could increase from 40% to over 60%, depending upon the marginal tax rate of the coverage provider. For example, if the coverage provider is a taxable entity such as a TPA or for-profit insurer, then a public sector or nonprofit plan could avoid this additional tax if the plan was considered the coverage provider (Ultimate Authority Approach) instead of the TPA or insurer that assists the plan in the administration. Therefore, nontaxable entities in particular may want to consider commenting that the Ultimate Authority Approach is preferred.*

### ■ **Employer Aggregation**

Are there any practical challenges presented by the application of employer aggregation rules to section 4980I for identifying the:

- Applicable coverage (AC) taken into account as made available by an employer?
- Employees taken into account for the age, gender, and high risk professions adjustments?
- Taxpayer responsible for calculating and reporting the excess benefit?
- Employer liable for any penalty?

### ■ **Cost of Applicable Coverage**

#### 1) **Determination Period:**

- What issues are raised by the anticipated need to determine the cost of applicable coverage for a taxable period reasonably soon after the end of that taxable period?
- How payments from an experienced-rated arrangement to or from an insurance company may be reflected in the cost of applicable coverage?
- Are there any administrative issues that might arise if, for purposes of determining the cost of AC, such payments or discounts are attributed back to the original tax year rather than accounted for during the tax year in which the amounts are paid or the discount applied?
- How do employers currently address such payments or discounts for purposes of determining COBRA premiums?
- What are the processes expected to be involved in calculating and allocating any excess benefit and the time period necessary to complete these processes?

#### 2) **Exclusion from Cost of AC of Amounts Attributable to the Cadillac Tax:**

- What methods can an insurer or TPA use to provide the amount of the income tax paid on the Cadillac tax?
- Are there any practical issues or legal barriers to passing through any or all of these amounts, or to separately identifying these amounts, such as federal rating rules or state insurance law?

- Are there alternative approaches that might allow for earlier billing of the amount, but that would not give rise to undue administrative complexity or difficulty?

### 3) **Income Tax Reimbursement Formula:**

- Are workable solutions to administrative challenges under the approach that uses the coverage provider's *actual* marginal tax rate?
- If a standard marginal tax rate is used, how could the standard marginal tax rates be determined? Should the standard marginal tax rate vary by categories of insurers? If so, how would this approach affect particular segments of taxpayers?

### 4) **Allocation of Contributions to HSAs, Archer MSAs, FSAs, HRAs:**

- Would the approach proposed for account-based plans where the costs for the period are allocated on a pro-rata basis work/be administrable?
- Are there workable/administrable alternative approaches?

### 5) **Cost of Applicable Coverage under FSAs with Employer Flex Credits:**

- How should the allocation of FSA amounts between non-elective flex credits and salary reduction be done when the total election for the FSA exceeds the maximum salary reduction amount permitted by section 125(i)?
- Are the potential outlined approaches for FSAs administrable?
- Do the proposed safe harbor rules make sense?
- Are there any other issues arising from the valuation of FSAs?

#### **Cheiron comments:**

- (i) *The notice does not state if the FSA calculations can exclude amounts for benefits not covered by the medical plan (such as dental & vision), nor does it recognize that a certain portion of FSA balances are forfeited. In addition, it appears (but is not certain) that employers would need to track FSA payments separately by those with self-only coverage vs. those with other than self-only coverage.*
- (ii) *Although HRAs are account-based plans, their operation can be very different than HSAs and FSAs in that many HRAs are unfunded with "contributions" only being made when benefits are actually paid out. Allocating these benefits different from other self-funded health benefits seems inconsistent. If Treasury and IRS intend to use "contributions" to mean the maximum annual HRA allocation, then we would be concerned that this would greatly overstate the value for many HRA plans and would be inconsistent with the use of COBRA rate calculations used.*

## ■ **Age and Gender Adjustment to the Dollar Limit**

### 1) **Determination of Age and Gender Distribution**

- Is the Current Population Survey as summarized in the BLS Table 8A an appropriate source of data for the age and gender characteristics of the national workforce or is there a better source?
- Is using the first day of the plan year for determining the composition of the employer's population administrable?
- Does using the first day of the plan year provide a representative age and gender distribution; and should employers be permitted to choose a different date?

### 2) **Development of Age and Gender Adjustment Tables**

- As mentioned above in the summary of the seven-step approach for development of age and gender adjustment tables (see, Table 2), is using the FEBHP cost or a broader national cost basis better for developing the cost by age and gender?
- Should the age and gender adjustments take into account the age rating scale adopted in regulations for the individual and small group market?

**Cheiron comment:** *The seven-step process would effectively be five steps developed by the IRS with the employer completing the last two steps. Even though the word "employer" is used for the last two steps, we presume that the same steps would also apply to multiemployer plans.*

■ **Notice and Payment**

1) **Notice of Calculation of Applicable Share of Excess Benefit**

- Are there any additional administrative and other issues raised by this notice suggested requirement?
- How should costs be reallocated/corrected when errors are found in particular if multiple coverage providers are impacted?

**CHEIRON'S ADDITIONAL COMMENTS**

We recommend that plan sponsors provide comments on any and all items that would assist them in determining any potential tax liability, simplifying calculations, and streamlining the administration of the Cadillac Tax. Of the numerous comment requests, we believe the following are most critical:

- *Person That Administers the Plan:* Express your preference between the day-to-day vs. ultimate responsible administrator as the paying entity, particularly in the case of self-insured public sector and multiemployer health plans.
- *Employer Aggregation:* Express your preference between a procedure for a controlled group member to determine its percentage of high-risk professionals for all benefit options or by benefit option.
- *Cost of Applicable Coverage:* Express your preference between using the person that administers the Plan's marginal tax rate vs. a standard marginal tax rate. Express your preference on allocation of contributions to health flexible spending arrangements particularly HRAs.
- *Age and Gender Adjustment to the Dollar Limit:* Express your preference between using the FEHBP claims versus using broader claims information to calculate the average cost by age and gender. Express your preference between using the proposed the first day of the plan year to determine composition of the employee population versus a different method, e.g., average or multi-point snapshot.

*Cheiron consultants can assist you in developing comments or analyzing the impact of the proposed approaches described in the notice.*

*Cheiron is an actuarial consulting firm that provides actuarial and consulting advice. However, we are neither attorneys nor accountants. Therefore, we do not provide legal services or tax advice.*

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