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IRS Traded in Your Chevy for a "Cadillac (ac-ac-ac-ac-ac) Tax": Agency Issues First Guidance on the Implementation Code Section 4980I

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By Taylor Bracewell

On February 23, 2015, the Internal Revenue Service (IRS) issued the first piece of guidance that discusses the excise tax, better known as the "Cadillac Tax," imposed by Section 4980I of the Internal Revenue Code of 1986, as amended, on employers that offer high-cost health coverage. Notice 2015-16 provides an overview of, and general background on, the provisions of Section 4980I and offers affected employers the opportunity to comment on certain issues relating to the assessment of the tax.

On February 23, 2015, the Internal Revenue Service (IRS) issued the first piece of guidance that discusses the excise tax, better known as the "Cadillac Tax," imposed by Section 4980I of the Internal Revenue Code of 1986, as amended, on employers that offer high-cost health coverage. Notice 2015-16 provides an overview of, and general background on, the provisions of Section 4980I and offers affected employers the opportunity to comment on certain issues relating to the assessment of the tax. Generally, the Notice discusses the purpose of the Cadillac Tax and defines and describes certain terms, such as

"applicable coverage" and "applicable dollar limit," which are relevant to determining whether the tax is imposed and the amount of the tax. Notably, the Notice does not provide guidance on compliance with the provisions surrounding the excise tax (it explicitly notes that it may not be relied upon as guidance for Section 4980I); rather, it provides a general description of the position the IRS plans to take or reconsider on certain issues.

The first section of this article provides a general overview of the Cadillac Tax, including its background and purposes. The second section explores the key terms, calculations, and details related to the imposition of the tax. Part three discusses the areas in which the IRS seeks comment from affected employers and addresses beneficial steps employers can take to prepare for final regulations.

I. Background and Purpose

Section 4980I was added to the Code by the Patient Protection and Affordable Care Act (PPACA) and becomes effective on January 1, 2018. Section 4980I, which was designed to raise revenue to offset other costs of the PPACA, imposes a 40 percent excise tax on any "excess benefit" of applicable coverage provided to an employee by an employer that is excludible from the employee's gross income. The rules for determining whether an employee's applicable coverage is an excess benefit mirror the rules for determining the "applicable premium" for purposes of the Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA).

The excise tax is not deductible and is not taken into account for purposes of determining the cost of applicable coverage. If the excise tax is imposed, it must be paid by the insurance provider (in the case of an insured plan), the employer (in the case of certain arrangements, such as a health savings account (HSA)), or the plan administrator. Practically speaking, however, the employer will be responsible for the tax, as insurance providers and third party administrators likely will pass on the cost in the form of higher premiums and fees.

The tax will be imposed on the amount of coverage the employee receives that is over the "applicable dollar limit" for the month. For 2018, the applicable dollar limit is $10,200 for self-only coverage, and $27,500 for coverage other than self-only coverage (i.e., coverage that provides minimum essential coverage to the employee and at least one other beneficiary). The applicable dollar limit will be adjusted yearly to reflect cost-of-living changes. Additionally, the limit may be adjusted for individuals who are "qualified retirees" and for individuals engaged in certain high-risk professions.

II. Key Points of Notice 2015-16 and Section 4980I

Applicable Coverage

Section 4980I defines applicable coverage as "coverage under any group health plan made available to the employee by an employer which is excludable from the employee's gross income under Code Section 106," regardless of whether (1) the employer or employee pays for the coverage, (2) the coverage is insured or self-insured, or (3) the coverage is provided by the employer or paid for by the employee with after-tax dollars. Section 4890I defines "group health plan" as any "plan (including a self-insured plan) of, or contributed to by, an employer (including a self-employed person) or employee organization to provide health care (directly or otherwise) to the employees." An "employee" is any current or former employee, surviving spouse, or other primary insured individual.

Section 4980I and the Notice list several categories of coverage that specifically are either excluded or included in the definition of applicable coverage:

Included Coverage	Excluded Coverage
accident or disability, general/auto liability insurance, supplemental liability insurance, and auto medical insurance	
on-site medical clinics	workers' compensation and credit-only insurance
insurance under which benefits for medical care are secondary to other benefits	
health flexible spending accounts (FSAs), Archer medical savings accounts (MSAs), and HSAs	coverage for long-term care and auto medical insurance
stand-alone dental or vision insurance	
specified diseases or illnesses and indemnity insurance, provided that payment for the coverage or insurance *is* excludable from gross income	specified diseases or illnesses and indemnity insurance for which the payment for coverage *is not* excludable from gross income

Notably, for purposes of HSAs and Archer MSAs, the cost of coverage is equal to the amount of employer contributions to the arrangement. Employer contributions are excludable from income under Code Section 106 and, according to the Notice, therefore include employee pre-tax salary reduction contributions, but exclude employee post-tax contributions. Unfortunately, navigating the distinction

between pre- and post-tax contributions as applicable coverage likely will result in additional administrative burdens for employers.

The Notice indicates that executive physical programs and health reimbursement accounts (HRAs) meet the definition of applicable coverage, though they are not listed as included coverage, and will likely be the subject of future guidance. The Notice also mentions that future guidance likely will address on-site medical clinics that offer only *de minimis* medical care to employees, excluding such clinics from applicable coverage but requesting comment on how to determine whether the clinics should be excluded. In addition to the above guidance, the IRS is considering issuing guidance clarifying whether self-insured dental and vision coverage, as well as employee assistance programs, should be excluded from applicable coverage.

Cost of Applicable Coverage

As mentioned previously, Section 4980I imposes the 40 percent excise tax on the excess of the cost of applicable coverage for a month over the applicable dollar limit for the month, which is one-twelfth the annual limit for self-only coverage or other coverage. These costs are determined under rules similar to those for determining the applicable premiums for COBRA, which are based on the cost of coverage for similarly situated non-COBRA beneficiaries (i.e., individuals who are receiving coverage under the employer-provided plan for a reason other than COBRA). The IRS expects that the cost of applicable coverage for purposes of Section 4980I will be based on the average cost of the applicable coverage for the employee and all similarly situated individuals.

The Notice indicates that the IRS is considering several methods for determining whether individuals are similarly situated. Individuals may be aggregated by benefit package, which would deem all individuals who are covered by a particular benefit package under an employer-provided health plan as similarly situated. Importantly, the IRS indicates that this aggregation would be made based on benefit packages in which the employees are *enrolled*, not on packages they are *offered*. Different types of benefit packages include a "standard" and "high" option or a PPO and HMO option. After aggregating employees by benefit packages, the employer must then disaggregate the employees based upon whether the employee is enrolled in self-only coverage or other than self-only coverage. For purposes of disaggregating the employees, there is no distinction in the number of beneficiaries covered by the other than self-only coverage, though the IRS requests comments on whether this should be the case.

Additionally, the Notice indicates the IRS is considering allowing employers to subdivide groups of similarly situated individuals further by disaggregating the employees based on standards such as nature of compensation, collective bargaining status, and specified job categories. However, employers may not disaggregate employees under this method while using any criterion related to an individual's health.

Although these rules generally will mirror the rules for determining the applicable premiums under COBRA, there are a few methods specific to Section 4980I. For example, any cost attributable to the excise tax is not included in the cost of applicable coverage, and an employer may treat a retired employee who has not yet reached age 65 as similarly situated with a retired individual who is age 65 or older. Additionally, the cost of applicable coverage for health FSAs is equal to the sum of salary reduction contributions and any reimbursements that exceed the salary reduction contributions, such as employer flex dollars. For HSAs and Archer MSAs, the cost of applicable coverage is equal to the total employer contributions, which include employee salary reduction contributions.

The IRS notes that guidance has not been provided on many issues related to calculating the cost of applicable coverage, which may result in complications for employers. For example, self-insured plans may face difficulty when determining the applicable COBRA premium. Although the Notice attempts to provide some guidance for self-insured plans, employers cannot rely on it and the actual rules may change in the future. Employers with self-insured plans should work closely with counsel in determining the cost of applicable coverage.

Applicable Dollar Limit

Whether the cost of applicable coverage is subject to the excise tax is based upon the excess of the cost over the applicable dollar limit, which varies based on self-only coverage and other coverage. The IRS notes, in certain cases, that an employee may have *both* self-only and other coverage. In such a case, the IRS is considering future guidance that clarifies that the applicable dollar limit depends on the employee's *primary* coverage, which is the coverage (self-only or other coverage) that accounts for the majority of the aggregate cost of applicable coverage.

The dollar limit will be adjusted for cost of living after 2018 and will be adjusted in the case of certain qualified retirees and high-risk professions, which include law enforcement, firefighters, paramedics, and others. Additionally, the amount may be adjusted due to the age and gender of the employer's workforce if the characteristics of such workforce are different from the national characteristics.

III. Request for Comments and Preparation

The Notice indicates there are many aspects of Section 4980I that will be the subject of future guidance because they are either unclear or undeveloped. Additionally, because the Notice is not binding, many of its interpretations of law and suggested courses of action may be subject to change. Entities potentially affected by the excise tax should take advantage of the legion of requested comments, which provide an opportunity for affected entities to shape the law and deflect potentially onerous administrative requirements.

Specifically, the IRS requests comments on the approach used to determine similarly situated individuals, treatment of on-site medical clinics, and any other Section 4980I-related issue that was or was not addressed in the Notice. The IRS indicates that it will develop rules governing the excise tax through a deliberate process, which will include multiple issuances of additional notices and requests for comments.

Stakeholders should submit comments on the Notice no later than May 15, 2015 and should include a reference to Notice 2015-16 in their comment.

Until the IRS establishes official rules for determining the excise tax, entities should begin collecting the relevant information for determining the tax in order to lessen the administrative burden of compliance as the effective date approaches. Although the current guidance may be subject to change, the ultimate process for determining the tax likely will be substantially similar to the approach discussed in the Notice. Employers should strongly consider commenting on the Notice and should work closely with counsel to keep abreast of any subsequent guidance.

Conclusion

Code Section 4980I imposes the 40 percent Cadillac Tax on amounts deemed to be excessive coverage. Because the tax was designed specifically as a revenue-generating measure, employers should not count on it being delayed past 2018. The best method to reduce costs associated with PPACA compliance is to begin the appropriate information-gathering and administrative processes early and to stay updated on any changes in the law.

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