



Health Care Reform Update

What You Need to Know Now



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Banyan Consulting LLC is pleased to present our new Health Care Reform series.

Over the next months and years, employers will be faced with numerous changes, many of which require regulatory clarification. We'll use this venue to keep you up to date, and on target with decisions that affect your plans.

What You Need to Know Now About: The Cadillac Tax

Another component of the Patient Protection and Affordable Care Act (PPACA) commonly referred to as the Health Care Reform Act is a tax on benefit-rich or “gold-plated” insurance plans. This tax is often referred to as “The Cadillac Tax” and, although it is not scheduled to go into effect until 2018 and may see several revisions in design before then, some plan sponsors are beginning to develop strategies to address it.

1. Why was “The Cadillac Tax” included in the Health Care Reform Act?

There are two primary reasons for the inclusion of The Cadillac Tax in the Health Care Reform Act. The first is to stem the rise of health care costs. One belief is that excessively benefit-rich plan designs encourages higher utilization, even overuse, of health care services by the plan participants and, as a result, have a greater influence in driving escalating health care costs.

The second reason is to generate revenue to help pay for covering the uninsured. The Congressional Budget Office (CBO) estimates that The Cadillac Tax will generate \$149B over a 10-year period.

2. What plan sponsors and plan designs are subject to The Cadillac Tax?

Beginning in 2018, if a benefit-rich insurance plan has an annual value of more than \$10,200 for an individual and \$27,500 for a family, then the insurance plan is subject to a 40% excise tax.

The 2018 annual value amounts of \$10,200 and \$27,500 include medical, prescription drugs, administrative fees and also include employee and employer contributions to flexible spending, health reimbursement or health savings accounts. Stand-alone vision and dental plans are not included in the calculation. However, there has been some recent confusion on the topic as it appears that the cost for a self-funded dental plan must be added to the calculation whereas a fully-insured dental plan does not. More guidance from the IRS/DOL is needed.

3. How is the 40% excise tax calculated and who pays it?

The 40% excise tax is calculated on the amount above the annual value amount. For example:

| | | |
|----------|--|-----------------|
| A | 2018 Annual Value Amount - Individual | \$10,200 |
| B | Insurance Plan's Actual 2018 Annual Value Amount - Individual | \$11,200 |
| C | Difference Insurance Plan's Amount v. Allowed Amount (B - A) | \$1,000 |
| D | 40% Excise Tax - "The Cadillac Tax" (C * 40%) | \$400 |

The excise tax is paid by the plan sponsor and is paid for each participant in excess of the 2018 allowed amount so, in this example, if the plan sponsor has 500 participants with Individual coverage in the insurance plan at an 40% excise tax of \$400 each participant, then the plan sponsor would pay a Cadillac Tax of \$200,000.

Of course, although the plan sponsor is responsible for paying The Cadillac Tax, many may pass on some, if not all, of the cost on to the plan participants in some form such as higher employee contributions.

4. Will the Annual Value Amounts for Individual and Family change after 2018?

Yes, it is anticipated that the Annual Value Amounts for subsequent years will be indexed and will increase. At the moment, the expectation is that the

amounts will increase, annually, by the medical inflation rate. Usually, this rate averages between 3%-5%.

It should also be noted that some plan sponsors might find in 2018 that they do not trigger the tax, however, because their insurance plan costs continue to rise faster on an annual basis than the medical inflation rate that in a subsequent year such as 2019, 2020, etc., they will trigger the tax.

5. I sponsor a grandfathered health plan. Am I subject to The Cadillac Tax?

Yes. The Cadillac Tax is applicable to both grandfathered and non-grandfathered health plans.

6. Are there any exceptions for certain groups of employees such as collectively bargained union groups?

During initial debate about implementing The Cadillac Tax for 2013, there was debate about excluding federal employees and union groups from the provision; however that was abandoned when the implementation of the tax was delayed to 2018. At this time, union groups will also be subject to the tax in 2018.

There are some adjustments to the current 2018 Annual Value Amounts for certain groups. For example, insurance plans that have an above average population of older workers or female workers may have higher 2018 Annual Value Amounts based on a still to be determined formula. The reasoning is that the higher cost to insure these groups is due to risk factors and not to benefit-rich plan designs.

This line of reasoning is also responsible for higher 2018 Annual Value Amounts for retirees and workers in high-risk professions (firefighters, coal miners, etc.). The amounts for these professions are set at \$11,850 for an individual and \$30,950 for a family plan.

7. How many plan sponsors might be subject to The Cadillac Tax?

Initially, when the tax was scheduled to go into effect in 2013 the CBO estimated that by 2016 19% of all workers would be subject to The Cadillac Tax.

With the delayed implementation date of 2018, several studies and estimates have been performed and assuming just an average annual trend of 8%, the projection is in the range of 40%-60% of all plan sponsors will trigger The Cadillac Tax. Of course, all these projections assume the plan sponsor does not make any significant plan design changes like increased deductibles and other employee out-of-pocket costs and that the details of The Cadillac Tax as currently constituted for 2018 remain unchanged.

8. Who will determine whether the insurance plan is subject to The Cadillac Tax and how will they do it?

The expectation is that the IRS will be responsible for determining who is subject to the tax and that they will use the amount reported on the employees' annual W-2 form.

As noted in a previously released Health Care Reform Update on W-2 Reporting (10/14/2010), employers will need to disclose the cost of employer provided health insurance on the employee's 2012 W-2 form. One of the reasons for including the cost of employer provided health insurance was simply to communicate the cost of the coverage to the employee. It is assumed that another reason for this W-2 requirement is to provide the IRS with the information needed in order to determine what plan sponsors are subject to The Cadillac Tax.

Once again, more guidance is needed on the matter. For the W-2 reporting, in addition to reporting the costs for the medical coverage and drug coverage, the employer must also report the cost for other employer-sponsored health care services such as executive physicals, employee assistance programs, Medicare supplemental policies, etc. If these additional health care services are reported in a lump sum format with the medical and drug coverage than the annual value amount may be overstated for purposes of calculating The Cadillac Tax.

9. What are the chances that The Cadillac Tax will be repealed or revised before 2018?

Repeal is unlikely.

Revision is a possibility. The initial proposed implementation of the tax was for 2013 but then delayed to 2018. Union groups wanted to be exempt from the tax when it was proposed for 2013. Those same groups will, most likely, want to be exempt from the tax in 2018. There are also so many other variables between now and 2018 that could dramatically change the design of the tax. It

is not unrealistic to expect that the current amounts of \$10,200 and \$27,500 or the amount of the excise tax could be changed several times before 2018.

10. What do I need to do now?

- First, determine if The Cadillac Tax in 2018, as currently designed, will affect you. Start by taking your 2010 annual fully-insured or self-funded rates and assume an annual average trend at 9%. At that percentage, your 2010 annual rates will be double the amount by 2018. Are you above the 2018 Annual Value Amounts of \$10,200 for an individual and \$27,500 for a family plan?
- If it appears that your plan will be subject to the tax in 2018 and you wish to avoid paying the tax, develop a strategy. Many plan sponsors are already implementing new strategies to address the 2018 tax either by encouraging healthier behaviors now in an attempt to reduce annual average trend rates, or, by increasing employee cost sharing on a more gradual basis leading up to 2018.
- As always, our recommendation is to always do what is in the best interest of the plan. For some plan sponsors, the best course of action may be to continue offering a benefit-rich plan design and pay The Cadillac Tax. The important thing is to know the options available to you.

If you have any questions on this or any new health care reform regulation, please contact a member of your Banyan Consulting team.