

# FYI<sup>®</sup> Alert

## For Your Information<sup>®</sup>

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## IRS Issues Additional Cadillac Tax Guidance

Beginning in 2018, the ACA imposes a nondeductible 40% excise tax on "applicable employer-sponsored coverage" in excess of specified statutory thresholds. Earlier this year, the IRS and the Treasury issued initial guidance on this tax. On July 30, they released a second notice that discusses additional aspects of the tax and requests comments. This guidance, coupled with the earlier notice, can help employers consider strategies for addressing the tax.

### Background

Beginning in 2018, the ACA imposes a nondeductible 40% excise tax on "applicable employer-sponsored coverage" in excess of statutory thresholds (in 2018, \$10,200 for self-only, \$27,500 for family) — commonly called the "Cadillac" tax. Earlier this year, the IRS and the Treasury (agencies) issued Notice 2015-16, which discussed potential approaches to the definition of applicable coverage, determination of cost of coverage, and the application of the dollar limits under the tax. (See our [February 24, 2015 FYI Alert](#).)

### Cadillac Tax Guidance

On July 30, the agencies released [Notice 2015-52](#), which discusses potential approaches to additional aspects of the excise tax that could be implemented in forthcoming proposed regulations. Specifically this notice addresses:

- Identification of the "coverage provider" liable to pay the tax
- Employer aggregation rules
- Allocation of the tax among coverage providers
- Payment of the tax
- Additional issues on the cost of coverage that Notice 2015-16 did not address

The agencies are requesting comments by October 1, 2015 on issues discussed in this notice, as well as in Notice 2015-16. They intend to issue proposed regulations after considering public comments on both notices.

This second notice covers a number of highly technical areas, and the following is a summary of some of its key points.

## Payment of the Tax

### Definition of “Coverage Provider”

The agencies' discussion of the “coverage provider” definition is a central aspect of this notice. Under the ACA, the employer is required to determine the amount of the Cadillac tax on a monthly basis and then allocate that tax among “coverage providers.” So, while the employer is the party required to calculate the tax, the coverage provider is the entity responsible for paying the tax. The identity of the coverage provider is clear under the statute in the case of insured health coverage (the insurer) and HSA contributions (the employer).

For all other types of coverage, including self-insured plans, the coverage provider is “the person who administers the plan benefits.” This term is not defined in the ACA or elsewhere in the Code. As discussed in the notice, the agencies are considering two alternative approaches for interpreting the “person who administers the plan benefits”:

- Under the first approach, this would be the entity responsible for performing functions such as receiving and processing claims for benefits, responding to inquiries or providing a platform for benefit information — typically, the plan's third-party administrator (TPA).
- Under the second approach, this would be the entity with the ultimate authority or responsibility under the plan with respect to administration of the plan benefits — typically, the plan sponsor or employer.

**Comment.** The second approach will better streamline the tax for employers from an administrative perspective, as those with only self-funded plans will not have to allocate payments to other coverage providers. For self-insured plans, this approach would also help mitigate the “tax on the tax” issue discussed below.

If the agencies adopt the first approach, on the other hand, an employer with a self-insured plan serviced by multiple vendors would — on a monthly basis — have to go through the onerous process of allocating the tax among those vendors. For example, an employer with a healthcare flexible spending account (FSA) vendor, a medical TPA and a carve-out pharmacy benefits manager (PBM) would need to allocate the tax among those three entities each month.

### The Tax on the Tax

The notice also addresses the cost of applicable coverage for amounts attributable to the excise tax itself – in other words, an additional tax on the excise tax. As discussed above, the coverage provider is responsible for paying the excise tax. If the coverage provider is an entity other than the employer, such as an insurer or TPA, it is expected that the coverage provider will pass the excise tax back to the employer. However, that reimbursement of the tax from the employer will be taxable income to the coverage provider. Since the excise tax is nondeductible for the coverage provider, the coverage provider will likely pass through to the employer not only the amount of the excise tax, but also an amount to pay for the additional tax the coverage provider will need to pay.

For example, assume a coverage provider that has to pay an excise tax of \$100,000 for an employer's plan passes that excise tax back to the employer. The coverage provider would have to pay taxes on the \$100,000 reimbursement from the employer. Assuming a 35% marginal tax rate, the coverage provider could require “grossing up” the reimbursement from \$100,000 to \$154,000 in order to cover the additional tax on the reimbursement (\$100,000 divided by [1.00 - .35]).

Under the statute, any portion of the cost of coverage attributable to the excise tax itself is excluded from the cost of applicable coverage in determining the amount of the excise tax. As articulated in the notice, the agencies are considering whether the amount of the gross up described above should be excluded from the excise tax. The notice provides an approach for reflecting that adjustment, should the agencies decide to exclude the additional payment from the cost of applicable coverage.

### Timing and Manner of Payment

The ACA does not address the timing or manner in which the tax must be paid. The agencies are considering using the Form 720 for payment of the tax, with a particular quarter in the calendar year being designated for payment.

**Comment.** The Form 720 for the second quarter of each calendar year is currently used to pay the PCORI fee. For more information on payment of the PCORI fee, please see our [June 8, 2015](#) *For Your Information*.

### Employer Aggregation

For purposes of the excise tax generally, all employers that are part of a controlled group are treated as a single employer. The notice asks for comments on the challenges this statutory requirement presents in identifying applicable coverage, determination of the age and gender adjustment (more on that below), identification of the taxpayer responsible for calculating and reporting the excess benefit, and employer liability for any penalty in the case of failure to properly calculate the tax.

### Age and Gender Adjustment to the Dollar Limit

The \$10,200/\$27,500 statutory thresholds that apply in 2018 can be increased based on the age and gender characteristics of all the employees of the employer in comparison to the national workforce; there is no downward adjustment, however. Generally, older individuals have higher healthcare costs on average than younger individuals, and younger women have higher costs than younger men. In the notice, the agencies propose to formulate adjustment tables that will help facilitate and simplify the calculation of this age and gender adjustment and ask for comments on this proposed approach.

### In Closing

This new guidance gives plan sponsors some additional insight into the direction the agencies are likely to take in proposed regulations, and enables them to better consider potential plan design strategies for coverage in 2018 and beyond. Comments are due to the agencies by October 1.

## Authors

Richard Stover, FSA, MAAA  
Julia Zuckerman, JD

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