The ACA “Cadillac Tax”: Outlook and Implications

DON HEILMAN | JANUARY 24, 2016
Agenda

• Introduction
• Current guidance
• Employer response
• Current strategies
INTRODUCTION
Introduction

• Starting on January 1, 2018-2020, an excise tax will be imposed on certain benefits plans that exceed a specific dollar threshold
  – Excise tax will be 40% of the benefit amount exceeding the dollar threshold
    • $10,200 (indexed) per year for self-only coverage
    • $27,500 (indexed) per year for other-than-self-only coverage
  – Employers are now planning in anticipation of this tax
Purpose

• The purpose of the tax is to:
  – Increase federal revenues
  • Employers will either reduce benefits or pay the tax
    – Reducing benefits results in more taxable compensation as it is not being “pre-taxed”
    – Reduced benefits also result in member cost sharing (deductibles, co-pays, etc.) being paid for with after-tax dollars
  • Expected to raise $120B over first decade (prior to delay – likely more, taking into account indexation)
  – Ultimately reduce medical trend (inflation)
  • New plan designs are thought to be more efficient
CURRENT GUIDANCE
Current Guidance

• With the delayed effective date, guidance that was expected, based on extensive comment period during 2015, is also delayed

• Tax applies to “applicable employer-sponsored coverage”
  – Includes group health plans sponsored by employers
    • Applies to self-insured, fully-insured, and grandfathered plans
    • Government plan coverage
    • There is no exclusion based on size
### Current Guidance

**Examples of applicable employer-sponsored coverage**

<table>
<thead>
<tr>
<th>Coverage Type</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>Medical and prescription drugs</td>
<td>Wellness programs</td>
</tr>
<tr>
<td>Employer contributions to a Health Reimbursement Arrangement (HRA)</td>
<td>Employer and pre-tax employee contributions to a Health Savings Account (HSA)</td>
</tr>
<tr>
<td>Fixed indemnity health coverage (only if pre-tax basis)</td>
<td>Executive physical programs (Likely to be included)</td>
</tr>
</tbody>
</table>

The tax applies to applicable employer-sponsored coverage provided to employees, former employees, surviving spouses, and other “primary insured individuals”.
• **Excepted benefits not subject to tax, such as:**

<table>
<thead>
<tr>
<th>Benefit Type</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Limited scope dental and vision coverage</td>
<td>Fixed indemnity health coverage purchased by the employee with after-tax dollars</td>
</tr>
<tr>
<td>Long-term care under an accident or health plan</td>
<td>Coverage only for accident and/or disability income</td>
</tr>
<tr>
<td>Liability insurance (including general liability insurance and auto liability insurance)</td>
<td>Coverage issued as a supplement to liability insurance</td>
</tr>
<tr>
<td>Workers’ compensation</td>
<td>Auto medical payment insurance</td>
</tr>
<tr>
<td>Credit-only insurance</td>
<td>Other similar coverage under which benefits for medical care are secondary or incidental to other insurance benefits</td>
</tr>
</tbody>
</table>

• **Dental, vision, and EAPs that qualify as excepted benefits**

• **After tax HSA employee contributions**
Current Guidance

- **Now** deductible, if subject to taxation
- Not adjusted for geography
- Potential adjustments, if population materially different demographically
- Higher thresholds: $11,850-single; $30,950-family (indexed) for:
  - Retirees (55+)
  - High risk professions (if majority), including (not all):
    - Law enforcement officers
    - Firefighters
    - Emergency technicians, paramedics, first responders
• Generally, the aggregate cost of the applicable employer-sponsored coverage is determined in a similar manner as COBRA
  – Excise tax applies if the cost of applicable coverage exceeds the threshold dollar amount
    • Actually calculated on a monthly basis

• Indexation:
  – 2019: CPI-U plus 1%
  – 2020 and beyond: CPI-U
Effects of Indexation

Actual Client Example Employee Only Coverage

- Compliance: Actuarial Value
- Static Plan
- Cadillac Threshold

Year | Compliance Value | Static Plan | Cadillac Threshold
--- | ----------------- | ----------- | ------------------
2017 | 84.03%           |            |                   
2018 | 80.33%           |            |                   
2019 | 77.42%           |            |                   
2020 | 74.48%           |            |                   
2021 | 71.53%           |            |                   
2022 | 68.72%           |            |                   
2023 | 65.28%           |            |                   
2024 | 62.00%           |            |                   
2025 | 58.90%           |            |                   

GALLAGHER BENEFIT SERVICES, INC.
• **Summary of annual aggregate cost over threshold - 2018 (active only)**

<table>
<thead>
<tr>
<th>Coverage Type</th>
<th>Amount over Threshold</th>
</tr>
</thead>
<tbody>
<tr>
<td>Medical and Prescription Drug</td>
<td>$457,000</td>
</tr>
<tr>
<td>Health Flexible Spending Account</td>
<td>$175,000</td>
</tr>
<tr>
<td>Retiree Health Savings (RHS)</td>
<td>$215,000</td>
</tr>
<tr>
<td>Total Over Threshold</td>
<td>$847,000</td>
</tr>
<tr>
<td>Excise Tax (40%)</td>
<td><strong>$338,800</strong></td>
</tr>
</tbody>
</table>
Sample Client Estimates - Illustrative

- **Summary of annual aggregate cost over threshold – 2020 (active only)**

<table>
<thead>
<tr>
<th>Coverage Type</th>
<th>Amount over Threshold</th>
</tr>
</thead>
<tbody>
<tr>
<td>Medical and Prescription Drug</td>
<td>$1,136,000</td>
</tr>
<tr>
<td>Health Flexible Spending Account</td>
<td>$180,000</td>
</tr>
<tr>
<td>Retiree Health Savings (RHS)</td>
<td>$250,000</td>
</tr>
<tr>
<td><strong>Total Over Threshold</strong></td>
<td><strong>$1,566,000</strong></td>
</tr>
<tr>
<td><strong>Excise Tax (40%)</strong></td>
<td><strong>$626,400</strong></td>
</tr>
</tbody>
</table>
Current Guidance

• Penalties
  – Employers subject to penalties for incorrectly calculating the excess benefit that causes the coverage provider to pay less tax
    • Penalty is equal to underpayment plus interest
    • Penalty can be waived if failure due to reasonable cause and not willful neglect and is corrected within 30 days
EMPLOYER/PLAN RESPONSE
Implications & Considerations

• Is hope a strategy!?  
• While delayed, compounded impact  
• Collective bargaining  
• Retirees
Implications & Considerations

• What others are doing, or contemplating:
  – If not already there, explore self-funding
  – Reduce benefits
  – Reduce or eliminate Health FSA elections
  – Reduce or eliminate HRA funding
  – Evaluate contribution structure
    • Affordability
    • Dependents
• What others are doing (continued):
  – Evaluate tier structure (single, double, multiple, ?)
    • Affects individual versus “family” rates, prevalence
  – Evaluate actuarial rating methodology, cross-subsidization issues
  – Assess network efficiency/quality
  – Evaluating rational approaches to:
    • Consumerism
    • Well-being
Implications & Considerations

• Collective Bargaining
  – Timing, versus CBA cycle
  – Assure optimization of higher permissible thresholds
    • Retirees
    • High risk professions
  – Total rewards – benefit concessions versus wages
  – HSAs versus HRAs (example: retiree health savings programs)
Implications & Considerations

• Retirees
  – Reassess early retiree coverage (where allowed by law)
    • Financing, while leveraging the marketplace exchanges
  – Evaluate rate cross-subsidization issues
  – Explore more cost effective Medicare retiree solutions
THANK YOU

Don R. Heilman
Area Sr. Vice President
Gallagher Benefit Services, Inc.
6399 South Fiddler’s Green Circle
Greenwood Village, CO 80111
don_heilman@ajg.com
303-889-2686