

Applicability and Impact of Impending Tax on “Cadillac Plans” under the Affordable Care Act

Prepared for the 2015 Massachusetts Municipal Association Annual Meeting

Previously, we alerted you to various aspects of the federal Patient Protection and Affordable Care Act (“ACA”), often referred to as “Obama Care”. Recently, we have been asked questions about a pending tax on so-called “Cadillac Plans”, high-end health insurance plans that typically have low, if any, deductibles and few cost-sharing features. Beginning on **January 1, 2018**, in an effort to slow increasing health care costs and finance expanded coverage, the federal government will impose a 40% excise tax on the annual value of employer-provided health plans that exceeds \$10,200 (\$875/month) for individual coverage and \$27,500 (\$2,290/month) for family coverage. The actual thresholds will be based on medical inflation between 2010 and 2018, using a measure that looks to the Federal Employees Health Benefits (FEHB) program. The purported goal of the tax is to discourage employers from offering high-end plans, which the federal government believes are contributing to higher health care costs. This law has potentially significant implications for municipalities.

Under the law, the value of coverage is calculated based on both the employer’s and the employee’s premium contributions. These thresholds may be increased for certain retirees and individuals in high-risk professions and pursuant to an age and gender adjustment. This provision, which is found in Internal Revenue Code §49801, taxes the amount, if any, by which the monthly cost of an employee’s applicable employer-sponsored health coverage **exceeds** the annual limitation (called the “employee’s excess benefit”).

The tax applies to both insured and self-funded employer plans, including those provided by municipal employers. In the case of fully-insured coverage that exceeds the applicable threshold, the issuer will be responsible for paying the 40 percent excise tax. In the case of self-funded coverage, the plan administrator (usually the employer) is responsible for paying the excise tax.

Beginning in 2019, the thresholds will be indexed to the rate of general inflation plus one percentage point. The Internal Revenue Service (IRS) is expected to issue guidance on the Cadillac tax requirements before they become effective in 2018.

The federal government has estimated that by 2019, 12 percent of all insured employees will subscribe to plans affected by the excise tax. There are no estimates as to what portion of this percentage will be public-sector employees, but the prevailing assumption is that they will be impacted at a much higher rate than private-sector employees. Indeed, the impact of this tax on municipalities could be far-reaching. For many municipalities, it has long been understood that relatively generous employee benefits, including employer-sponsored health insurance, are granted in lieu of higher pay. Because the threshold in the law is tied to inflation—not health care

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costs, which historically increase at a much faster rate - it is likely that more plans will be subject to the tax each year.

In most cases, the tax will be levied on the health insurance company. However, experts predict that insurers will simply pass the tax along to their insureds. At this time, therefore, it appears that a municipality offering one or more Cadillac Plans have four (4) options:

- 1) eliminate employee health plans subject to the tax;
- 2) alter health plan design so that the plan falls below the tax threshold;
- 3) do nothing to the plan and pass the tax on to employees; or
- 4) do nothing to the plan and pay for the tax.

In the immediate future, municipalities should begin examining their health insurance offerings to determine which plans they offer, if any, will be subject to the tax. Municipalities should confer with their insurance advisor or broker to estimate the financial impact of the new tax and discuss possible steps that can be taken to address the issue before the law takes effect in 2018. The process for changing health insurance benefits, particularly for union employees (where bargaining may be required), can be time-consuming and complicated.

As always, you may contact a member of the firm's Labor and Employment Practice Group at 617.556.0007 with any questions or concerns regarding the impact of the tax or any other aspect of the Affordable Care Act.

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