Now is the Time to Plan for the Cadillac Tax

Employers across America breathed a sigh of relief late last year when Congress passed, and the President signed, a bill delaying the effective date of the so-called "Cadillac Tax" – from 2018 until 2020. The Cadillac Tax is a provision of the Affordable Care Act (ACA) designed to help fund the expansion of insurance coverage and encourage employers to make their health plans more efficient. But the tax has proven to be deeply unpopular among employers, unions, and across the political spectrum. While the delay is welcome by most employers, it has not relieved the sense of uncertainty since the law remains in effect, though employers won a minor concession in obtaining the ability to deduct the cost of the tax from revenue for tax purposes. President Obama's recent budget proposal signals that the Administration will consider other small changes, such as adjustments for regional differences in healthcare costs. But President Obama is not likely to sign legislation repealing the tax altogether.

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What is the Cadillac Tax?

The Cadillac Tax is slang for a 40% excise tax on the value of any plan that exceeds the threshold that the government considers to be a "rich" (higher premium) employer-sponsored health plan. It is provided for under section 9001 of the ACA. The purpose of the tax was to help subsidize the cost of premiums for those newly covered under the ACA and to provide an incentive to employers to reduce pre-tax benefits, negotiate for better prices, and steer enrollees toward lower-cost providers. An unstated goal is to increase federal tax revenues by reducing the exclusion from gross income for group health plan expenses.

The tax – as of this writing – will apply to all health insurance plan costs that exceed $27,500 for families and $10,200 for self-only coverage. Certain higher-risk-profession workers will have higher limits: $11,850 for individual coverage and $30,950 for families. The actual starting thresholds will potentially be adjusted based on actual plan cost changes in the years leading up to implementation, and then the thresholds are set to be adjusted annually based on the Consumer Price Index (CPI).

Why the Delay?

There are major objections to this provision of the ACA. First, the tax has a disproportionate impact on members of labor unions, public employees, and other middle-class workers where higher wages were traditionally traded for richer health benefits. Many of those plans are now the subject of cost reduction actions by employers.

Second, even though the tax was initially designed to target disproportionately rich benefit plans, the reality is that due to the structure of the threshold indexing, the tax will likely impact nearly all plans over time. Since the threshold will be indexed by the CPI, which historically runs significantly lower than health plan cost inflation, these numbers eventually converge, turning the Cadillac Tax into the Chevrolet Tax, impacting many more than early proponents of the Cadillac Tax may have realized. For instance, in recent years, health plan costs have been growing at a rate that is 2 ½ times the general CPI.

Third, there are wide variations in the geographic effects of the tax. For example, due to the cost of health plans in various regions, there are some states that will find plans there affected by the tax as soon as the tax takes effect in 2020, while other states may not be affected until 10 years later. President Obama's recent budget proposal provides that employers could offer more generous coverage in states where "gold" level plans offered on the ACA's insurance exchanges cost more than the Cadillac Tax limits. But other elements of the proposal, including overall spending of $4 trillion, are considered "aspirational" and not likely to pass under the current Congress.

How the Tax Will be Applied

Employee Only Covered

An individual plan that costs $13,000 would be levied a Cadillac (excise) tax of $1,120 per employee covered.

Example:

$13,000 (individual health plan cost) - $10,200 (government threshold) = $2,800 (taxable amount)
$2,800 X 40% Tax = $1,120

Family Covered

A family plan that costs $33,000 would be levied a Cadillac (excise) tax of $2,200 per employee covered.

Example:

$33,000 (individual health plan cost) - $27,500 (government threshold) = $5,500 (taxable amount)
$5,000 X 40% Tax = $2,200

Additionally, the law creating the tax calls for contributions to Health Savings Accounts (HSAs) and other flexible benefit offerings to be included in the health plan price when determining the cost of the plan, and consequently, the tax. Trade groups, some lawmakers, and others commonly recognize that this requirement may eliminate or reduce the incentive for employers to contribute to HSAs and may endanger the ability of employees to pay their medical expenses until a high deductible health plan goes into effect.

What are the Implications of the Delay?

The delay in the effective date of the Cadillac Tax is designed to provide lawmakers time to address these concerns, effectively kicking the can down the road. While providing some temporary relief, the delay in the tax has added a layer of uncertainty as to how plans would be taxed and at what threshold.

Could the tax be eliminated? This seems unlikely as the tax is projected by the Congressional Budget Office to generate about $90 billion in revenue. Any legislative fix would require that, should the tax be repealed entirely, an equal offsetting source of tax revenue will have to be found. This will not be easy in an election year and political reality would prevent changes without an offset in any case.

What to Watch For

While there have been efforts to eliminate the tax, including the "Ax the Tax on Middle Class Americans' Health Plans Act," the more likely scenario will be an exclusion of at least the employee portion of the contribution to HSAs, wellness programs, Flexible Spending Accounts, and Health Reimbursement Arrangements. Lobbying groups will continue to push to have ALL contributions (employer and employee) eliminated; the employee contribution is most likely to be exempted.

The latest attempt, introduced in early February, is the Health Care Savings Act of 2016. The bill, authored by Orrin Hatch, Senate Finance Committee Chairman, and Congressman Erik Paulsen, a member of the House Ways and Means Committee, provides a definition for "employer-sponsored coverage" regarding the Cadillac Tax and exempts employee contributions from calculation of the tax. Salary-reduction contributions through cafeteria plans would be treated as employee contributions due to the fact that they are employee-directed.

In the interim, employers will continue to turn to HSA-eligible plans to reduce cost and mitigate the impact of whichever provisions of the Cadillac Tax survive over the next four years. As previously noted, without corrective legislation, the wide variances in the cost of health plans geographically will cause what were once considered to be plans of average cost in some states to be hit by the tax almost immediately.

Because consumer-directed health (CDH) plan premiums are, on average, lower than traditional group health plans, employers are likely to increase their adoption of these arrangements. HSA Bank expects HSA plans to experience a rapid growth as a smart alternative to higher-cost traditional health plans. Because they are often less expensive than traditional plans, HSA plans are a viable alternative that employers concerned about the Cadillac Tax would do well to consider.

Illustration of How the Cadillac Tax Rises with the Plan Cost

Employee Only Covered

Cost of Plan*	Tax*
$12,000	$ 720
$13,000	$1,120
$14,000	$1,520
$15,000	$1,920
$16,000	$2,320

Family Covered

Cost of Plan*	Tax*
$30,000	$1,000
$32,000	$1,800
$34,000	$2,600
$36,000	$3,400
$38,000	$4,200

**Per covered employee*

Conclusion

Despite the respite provided by the delay in the effective date, the Cadillac Tax will loom large for employers until more concrete reform is enacted, most likely sometime between the presidential election and 2020, the year in which the tax is currently due to take effect. In the meantime, CDH/HSA plans continue to provide the best bet for those employers planning for the worst effects of the tax.

According to a study completed by the International Foundation of Employee Benefits, 59.5% of respondents to a survey the group conducted said that without future changes, their organization would trigger the tax if it took effect today. Without future changes, 62.2% also responded that their organization would trigger the tax upon its effective date in 2020. Respondents totaling 39.6% said their organization was working on changes to avoid the tax, while 38.5% responded that their organization is moving to a consumer-directed health plan with an HSA.[1]

Consumer-directed health plans coupled with HSAs have helped hundreds of thousands of businesses across the country save on their healthcare costs. HSA Bank, an innovative leader in the administration of health benefit accounts, has partnered with more than 35,000 employers to provide effective programs.

About the Author

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Kevin returned to HSA Bank in 2015 after serving as our Vice President - National Sales from 2007-2010. As SVP Director of Sales, Kevin is responsible for leading the sales team and driving revenue. He has nearly 20 years of experience in the insurance and financial services industry, as well as banking and covering a diverse spectrum of employee benefits and insurance products and services. He most recently served as Senior Vice President, Director of Operations at UMB Healthcare Services. Kevin has served as president of a number of industry and private organizations on a local and national level, and is a board member of the American Bankers Association HSA Council.

About HSA Bank

HSA Bank uses technology and innovation to simplify the health account experience while offering reliable and responsive support to our business partners and members. This commitment to leadership has propelled us to become one of the nation's largest providers of Health Savings Accounts (HSAs), serving 2 million members with nearly $5 billion in assets under administration. We also offer Flexible Spending Accounts (FSAs), Health Reimbursement Arrangements (HRAs), and Commuter Benefits (Mass Transit and Parking). Headquartered in Wisconsin, HSA Bank is a division of Webster Bank, N.A., Member FDIC. Webster Financial Corporation (NYSE: WBS) is the holding company for Webster Bank, N.A.

Contact Us

For assistance in learning how Health Savings Accounts can help your organization escape the Cadillac Tax, contact our Business Relations team at 866-357-5232.

Note: A wide variety of factors influence the cost trajectory of a group health plan, including claims experience, benefit design, demographics, provider networks, and funding mechanisms. HSA plans can help control costs but do not guarantee avoidance of the Cadillac Tax. We recommend that you work with qualified professionals to design the best plan for your organization.

[1] ACA Cadillac Tax and Reporting: 2015 Survey Results, International Foundation of Employee Benefit Plans, September 2015.

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