

## Health Policy Brief

# Are employers prepared for the “Cadillac” tax?

Produced by the Deloitte Center for Health Solutions and the Deloitte Center for Regulatory Strategies



### Executive summary

Although much of the Affordable Care Act (ACA) has been implemented, some major provisions are not yet in effect. Among these is the “Cadillac” tax, an excise tax on high-cost, employer-sponsored health coverage. Beginning in 2018, the Internal Revenue Service (IRS) will assess a 40 percent tax on the value of certain health benefits above the threshold amounts of \$10,200 for individual coverage and \$27,500 for family coverage. Health insurance issuers and self-funded group health plan sponsors must pay the tax on any dollar amount beyond the caps that is considered “excess” health spending. After 2018, the IRS will adjust the premium thresholds based on the consumer price index<sup>1</sup>.

As the Administration moves forward with the regulatory process, employers across all industries should consider whether and how the tax will affect their health benefit offerings; their ability to attract, retain, and motivate employees; and their regulatory compliance. Health insurance plans and other health care industry players should analyze the potential implications and options for product offerings and other impacted aspects of their business. Deloitte’s 2015 *Survey of US Employers* finds that most employers expect the Cadillac tax to influence their benefits strategy. Despite this finding, 63 percent of surveyed employers have not calculated their exposure to the tax or modeled what year the tax will apply, and most employers (68 percent) have not begun reducing the generosity of health benefits to move away from higher-cost packages.

This Health Policy Brief presents findings from Deloitte’s 2015 *Survey of US Employers* to highlight steps organizations have taken in anticipation of the Cadillac tax taking effect.

### What is the Cadillac tax?

The excise tax on high-cost, employer-sponsored coverage – popularly called the “Cadillac” tax – was included in the ACA in lieu of changes to longstanding tax preferences for employer-sponsored health benefits for employees. The Cadillac tax is intended to help fund the ACA’s health coverage expansion and control the growth of health care costs in the private health insurance market by creating a disincentive for employers to offer more robust health benefits.

The Cadillac tax applies to all employer-sponsored coverage, whether self-funded or fully insured, including retiree coverage and employer-sponsored group health plans purchased under the Small Business Health Options Program (SHOP Exchanges) and on private exchanges.

It is important to understand that the excise tax applies to both employer and employee premium contributions for certain health benefits. The tax also generally applies to tax-preferred contributions to certain health savings vehicles (e.g., health care flexible spending arrangements, health savings accounts). Because the excise tax is calculated based on employer and employee contributions to health benefits, companies will not be able to reduce potential excise tax liabilities simply by increasing employees’ contributions to premiums.

Employers are responsible for calculating the total value of health benefits subject to the Cadillac tax for each employee on a month-by-month basis and determining whether that value exceeds set thresholds, which in 2018 are \$10,200 for self-only coverage and \$27,500 for all other types of coverage. The value of benefits exceeding the thresholds is subject to a 40 percent non-deductible excise tax. Employers are responsible for apportioning the Cadillac tax among applicable coverage providers (e.g., health insurers and other entities responsible for administering health care benefits subject to the tax)<sup>2</sup>.

The Cadillac tax takes effect for tax years after December 31, 2017. The Congressional Budget Office (CBO) projects that the tax will increase federal revenue by \$91 billion from 2018 through 2025<sup>3</sup>. CBO expects most of the increase in revenue to result from employers shifting employee compensation away from more generous health benefits to other forms of compensation that are subject to federal income and payroll taxes.

The Cadillac excise tax applies to health care coverage sponsored by:

- Private businesses
- Non-profit organizations
- State and local governments
- Labor unions
- The federal government, via the Federal Employee Health Benefits Program (FEHBP)

#### Where are we in the regulatory process?

The Department of the Treasury and the IRS has issued two notices seeking comments on the Cadillac tax. The first (Notice 2015-16) primarily focused on the definition of applicable coverage (e.g., health benefits subject to the excise tax), providing information that will help organizations begin to assess their health benefits packages and model when they might incur the tax for the first time. The second notice (Notice 2015-52) primarily focused on the administration of the excise tax and highlighted the complexity of calculating the value of applicable coverage for each employee on a monthly basis and apportioning any tax liability among the various entities that administer the health benefits.

Treasury and the IRS plan to address comments received in response to the two notices in proposed regulations. The notices state that the proposed regulations "will provide further opportunity for comment, including an opportunity to comment on the issues raised in the preceding notices.<sup>4</sup>" The Administration is expected to issue final regulations on the Cadillac tax before President Obama leaves office in January 2017.

Although debate about the excise tax has increased, making changes to the tax will face steep odds during this current Administration. The next Administration and future Congresses could seek to repeal or change the Cadillac tax, but organizations would be well-advised to move ahead with their compliance activities to mitigate the possibility of unanticipated tax liabilities. In addition, organizations in the health care sector should consider evaluating how the tax might influence the overall demand for health care services and products, and potentially impact their overall business strategies.

#### Are employers prepared for the Cadillac tax?

Deloitte's 2015 Survey of US Employers finds that most employers expect the Cadillac tax to influence their benefits strategy. Despite this expectation, about 63 percent of employers have not calculated their exposure to the tax or modeled to determine the first year that the tax will apply. Even more employers (68 percent) have not started to reduce the generosity of health benefits to move away from higher-cost packages. Finally, only about one in four surveyed employers have developed a strategy to offer several benefit coverage levels (e.g., through a private health insurance exchange) to remove options that exceed the 2018 Cadillac tax thresholds.

## Most expect the new tax to affect the benefits they offer

According to the survey, most employers anticipate that the Cadillac tax will influence or somewhat influence their ability to:

- Continue offering valuable health benefits to their employees (91 percent)
- Rely on health benefits to recruit and retain talent (92 percent)

Moreover, a large majority (92 percent) of employers report that the tax will have an adverse financial impact on their company and employees.

As depicted in Figure 1, executives at larger companies are the most likely to report concerns about the tax's influence on their ability to rely on health benefits as a talent recruitment and retention strategy: 70 percent of firms with 2,500 or more employees report this concern, compared with 50 percent of firms with fewer employees. Very large firms also are the most likely to report other concerns about the tax, but talent recruitment and retention is the one most widely shared.

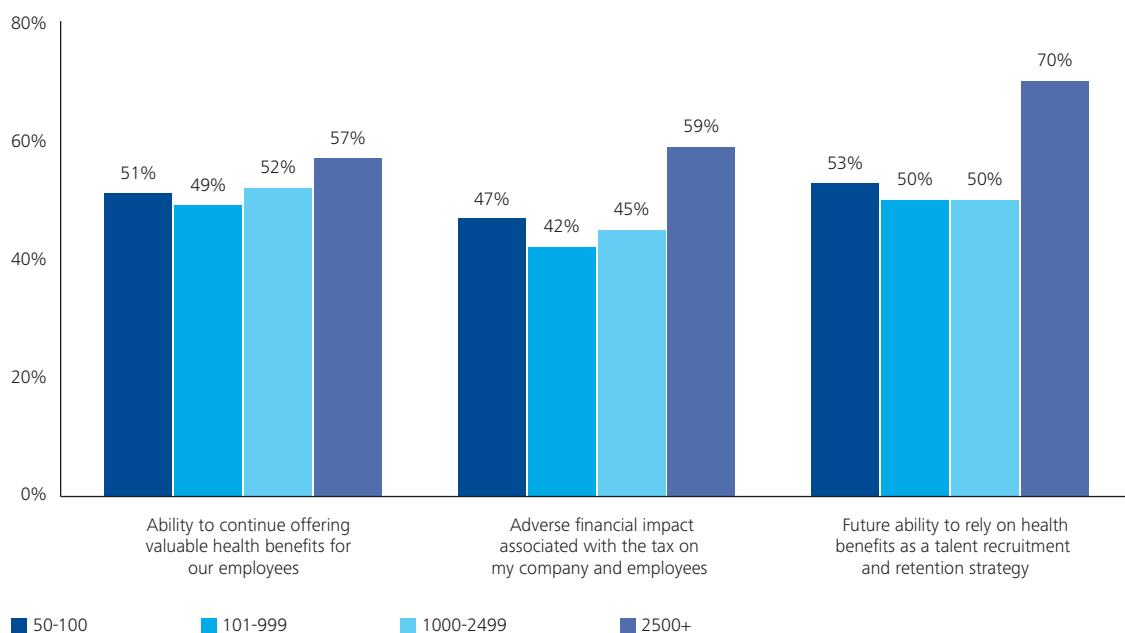
Concern about the tax's effect is most widespread among firms in the finance industry. Sixty-six percent of respondents from this industry report that they expect the tax to influence their company's ability to continue offering valuable health benefits to their employees. Companies in the Eastern US are less likely to report concerns – for example, 42 percent expect the tax to affect their ability to continue offering valuable health benefits for employees, compared with 60 percent expressing this concern in the Western part of the country.

**Figure 1. Employer responses to the level of influence of the Cadillac tax – by firm size**

Percentage of employers who expect the Cadillac tax to influence\* their company in the following ways

Please rate how much influence you anticipate the Cadillac tax to have on your company's ability to do the following:

\*Chart shows percentage of employers who answered (8,9,10) on a scale of 1 to 10 where 1 is "no influence" and 10 is "major influence"



## Most firms are not prepared to implement the Cadillac tax

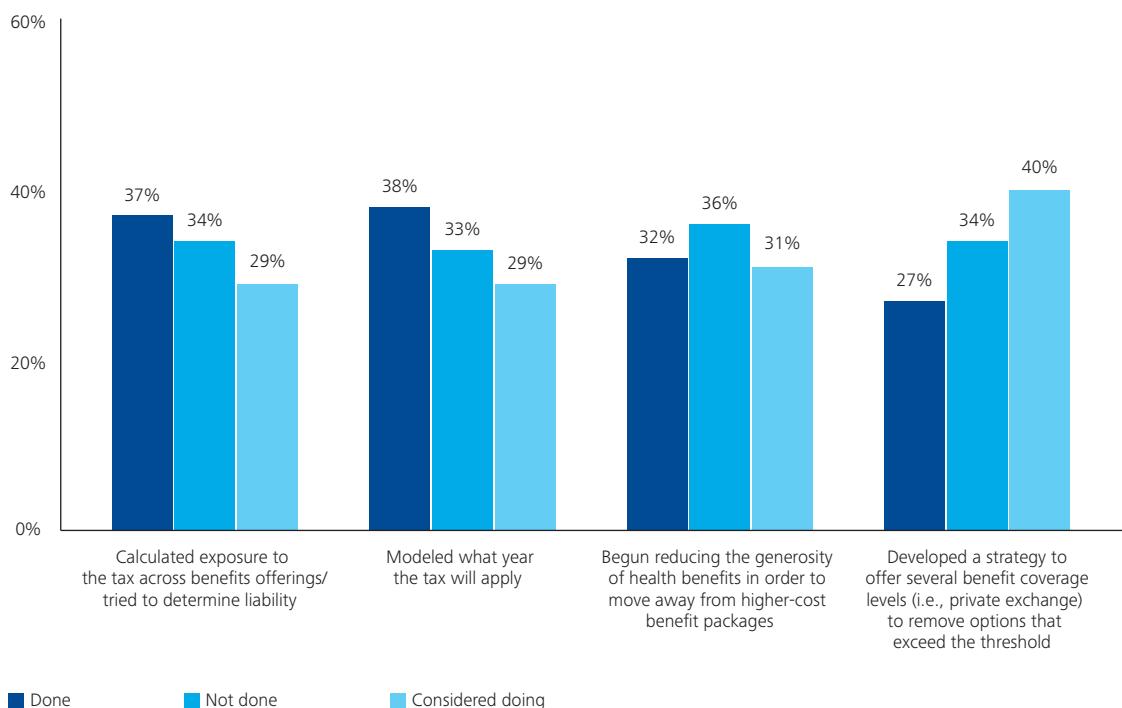
The survey asked employers about steps they have taken to prepare for the tax. These include:

- Calculating exposure to the tax across benefit offerings or trying to determine liability
- Modeling what year the tax will apply
- Beginning to reduce the generosity of health benefits to move away from higher-cost/higher-value benefit packages
- Developing a strategy to offer several benefit coverage levels (e.g., through a private exchange) to remove options that exceed the threshold.

Employers are about evenly split in their responses that they have not taken these steps, are considering doing so, or have taken one or more steps (Figure 2). Calculating their exposure and modeling the first year that the tax will apply are the actions that companies most often report having taken.

**Figure 2. Employer preparedness for the Cadillac tax**

Which of the following has your company done to prepare itself for the Cadillac tax?



Source: Deloitte Center for Health Solutions 2015 Survey of US Employers

Responses to these questions vary by company size, industry, and where the companies are located, and tend to be consistent in direction (if not magnitude) across the questions. The largest companies are the least likely to report being unprepared, although even among the largest companies a significant share of respondents report that they have only considered or haven't yet taken each step. For example, 19 percent of large companies report they have not calculated exposure to the tax or tried to determine their liability.

Looking at the responses by industry (Figure 3), there is consistency in the pattern of responses across the questions. Companies in the finance and services industries are the most likely to report they have not yet calculated exposure to

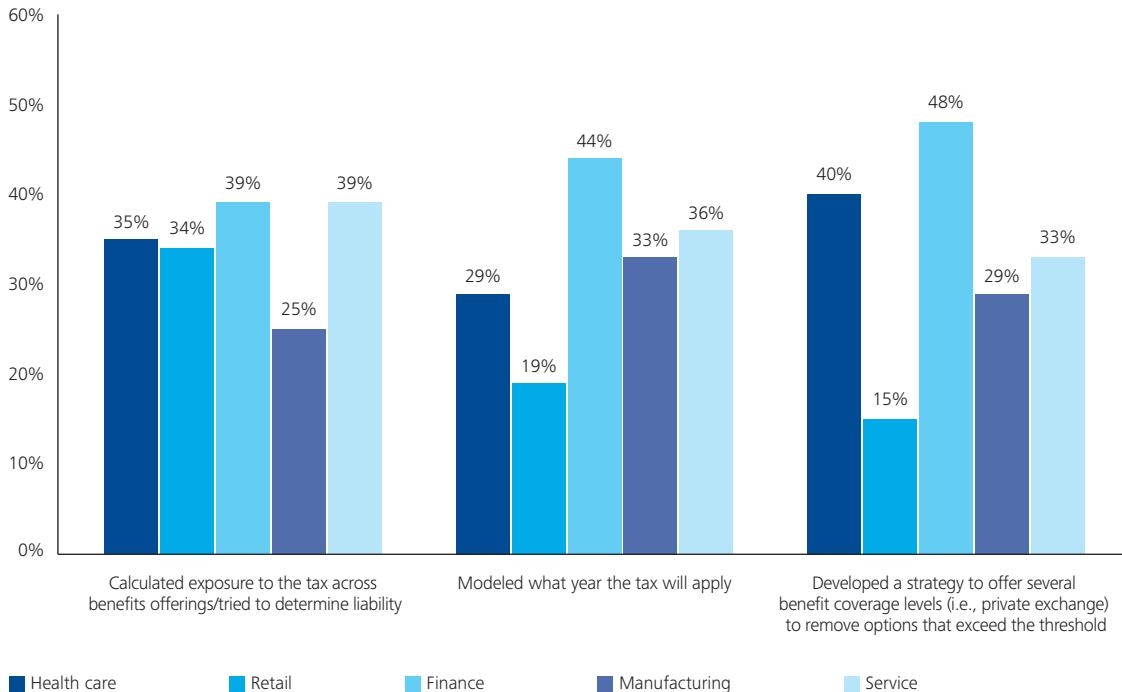
the Cadillac tax across benefits offerings, tried to determine their potential liability, or modeled what year they will incur the Cadillac tax. By comparison, the results show that manufacturers are most likely to have calculated exposure to the Cadillac tax across benefits offerings or tried to determine their potential liability, and retailers are most likely to have modeled what year they will incur the Cadillac tax.

Finally, responses to these questions vary by region of the country; however, the differences are not large and the pattern of responses across the four questions is not always distinct.

**Figure 3. Percentage of employers who have not begun preparing for the Cadillac tax – by industry**

Which of the following has your company done to prepare itself for the Cadillac tax?\*

\*Chart shows percentage of employers who answered "not done"



Source: Deloitte Center for Health Solutions 2015 Survey of US Employers

## **Implications**

**Employers should consider acting now.** The Cadillac tax is scheduled to take effect in 2018 and is likely to have a considerable impact on employers. Companies that offer health benefits to their employees should assess how the tax might affect their benefit offerings. In addition, they should determine whether they are prepared to calculate the value of their employee health benefits and to apportion any tax liability among the various benefit providers. Companies have limited time to make changes to avoid any unexpected tax liabilities and put in place the processes needed to comply with these significant new administrative requirements. Importantly, it could take several years to realize the impact of initiatives that have the potential to reduce longer-term health care costs. Employers should consider starting now to be positioned to potentially achieve a reduction in health care costs before the tax takes effect.

**Hospitals, health plans, and life sciences companies should take heed.** In addition to the impact the Cadillac tax will have on health care organizations as employers, the tax could affect them in areas beyond their employee benefit offerings. For example, demand for some products and health care provider services could be lowered if employers reduce the generosity of health care benefits offered to employees. Also, any shift in the employer-sponsored market towards less-generous plans with lower premiums may drive health plans to significantly adjust or limit their insurance product offerings, which could translate to even greater revenue and competitive pressures for health plans. In addition, if the tax further accelerates the move towards consumer-driven health care and drives greater utilization of public and private exchanges to purchase health benefits, plans may need to evaluate their strategy to compete effectively in this arena.

Hospitals, health plans, and life sciences companies should consider incorporating the tax's potential impact on service utilization and revenue generation into their future business plans and strategies, as companies make changes to hold the overall premium for employee health benefits below the thresholds for the tax and seek to control the administrative complexity of compliance.

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## Methodology

Deloitte's survey, fielded in late February and early March 2015, included 700 respondents from a variety of employers. Firms ranged in size from small (50-100 employees) to very large (more than 2,500 employees) and come from health care, retail, finance, manufacturing, service, and other industries. Respondents included owners and CEOs as well as executives responsible for health benefits programs. The survey, which covered a range of topics related to health care benefits, was administered online (Figure 4).

**Figure 4:** (Note: Totals may not sum to 100 percent due to rounding.)

	N	%
<b>Firm size (# of employees)</b>		
50-100	195	28%
101-999	309	44%
1,000-2,499	58	8%
2,500+	138	20%
<b>Industry</b>		
Health care	78	11%
Retail	73	10%
Finance	70	10%
Manufacturing	94	13%
Service	195	28%
All other	190	27%
<b>Role in company with regard to health benefits</b>		
Decision-maker re: health benefits	516	74%
Has influence in the decision-making process but not decision-maker	175	25%
Other	9	1%
<b>Firm region</b>		
East	142	20%
Midwest	141	20%
South	231	33%
West	158	23%
<b>Role/title of respondent</b>		
Owner	119	17%
CEO or president	112	16%
CFO	60	9%
COO	47	7%
CHRO	92	13%
Executive responsible for health benefits programs	103	15%
Office Manager or Benefits Administrator	167	24%
<b>Offers part-time or retiree benefits</b>		
Retiree	400	57%
Part-time	388	55%

## Endnotes

1. Internal Revenue Code Section 4980I.
2. Internal Revenue Code Section 4980I.
3. Joint Committee on Taxation, 9/28/2015, JCX 130-15.
4. IRS Notice 2015-16, IRS Notice 2015-52.



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