Between a Rock and a Hard Place


Presented by
Mark Holloway, J.D.
Elizabeth Vollmar, J.D.
Compliance Services, Lockton Benefit Group
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Introduction, Acknowledgements, and Agenda
Introduction and Acknowledgments

- Welcome to our webcast
- Introductions and topic summary
- Handouts
- Questions and answers
- Replay link
- Acknowledgements
Agenda

- Cadillac Tax
  - Overview
  - What’s included/excluded
  - Adjustments to tax
  - Procedural issues
  - Impact/future/Lockton resources

- Embedded OOP Rules (2016)
Cadillac Tax
Policy argument that unlimited, tax-free nature of healthcare results in inefficiencies and increased costs

"We need to tax benefits like the ones that the executives at Goldman Sachs have, the $40,000 policies."

-White House, 2009

Cadillac tax is intended to slow growth of health costs and be a revenue raiser that helps offset the $1 trillion cost of the ACA.
As time marches on, more plans will be subject to the tax:
Lockton’s Clients (2015)

Percentage of clients triggering the Cadillac Tax

[Bar chart showing percentage of clients for 4% trend, 6% trend, and 8% trend in 2018, 2023, and 2028.]
What is the Cadillac Tax?

- Beginning in 2018, a 40 percent non-deductible excise tax on health benefits with values exceeding $10,200 individuals; $27,500 for “other than individual coverage” (indexed)
  - Multiemployer (union) plans can use $27,500 for single and family coverage
    - Unions beginning to realize this is a huge issue for their plans
      - Note: ILA contract with West Coast Port Operators requires contributing employers to cover cost of Cadillac Tax (WSJ, 5/28/15)

- Is it really a 40% tax?
  - For insurers, the tax will be built into premium rates; premium payments are taxable income to insurer
  - Net tax effect = 60% tax
What is the Cadillac Tax?

- IRS indicates tax calculated based on employee’s *enrollment* in coverage
  - No safe harbor based on coverage *offered*

- No formal guidance yet from IRS
  - IRS has issued one RFI; another one in the works
    - See *Alert*, 2/24/15
  - Game plan is to have final rules in place by 2016
What’s Included in the Cadillac Tax?

- Major medical coverage
  - IRS: “How do employers develop COBRA rates?”
- HSA contributions
  - Employer and pretax employee
    - But not after-tax employee contributions
- Health FSA benefits
  - But maybe not limited scope FSA?
- HRA allocations
  - But maybe not limited scope HRA?
- Executive physicals
- On-site clinics
  - Exception for clinics providing minimal care
  - IRS asked for comments on this
What’s *Excluded* From the Cadillac Tax?

- Dental and vision coverage*
- Employee assistance programs (EAP)*
- Fixed indemnity or dread disease coverage*
  - But only if premium paid after-tax by employee
- Long-term care insurance*
- Coverage for some expatriates
  - If transferred (but not assigned to) U.S.
    - See blogpost, 12/24/14

* Must qualify as an excepted benefit (see blogpost, 12/24/13)
Adjustments to dollar thresholds ($10,200; $27,500)*

- Health care cost adjustment: percentage increase if actual growth of U.S. health costs from 2010–2018 exceeds projections from 2010
- Age and gender adjustment: details TBD by HHS
- Inflation: After 2018, adjusted for change in CPI after the year that is two years prior to the relevant year, and increased by 1% for years prior to 2020; rounded to nearest multiple of $50.

*IRS will likely calculate and communicate adjustments factors.
Cadillac Tax—Adjustments, Part II

- Special rule if dependent coverage “varies” from employee-only coverage
  - Must use lower employee-only dollar threshold ($10,200) when calculating tax
    - In other words, can’t offer MEC to dependents and MV coverage to employees

- Note—no adjustment if plans enrollees happen to live in high-cost areas

- Special rules for retiree medical
  - Increased $1,650 single/$3,450 family for retirees <65 (indexed)
    - This adjustment applies in lieu of the health care cost and age/sex adjustments on prior slide
  - Retiree must be >55 and not covered by Medicare (e.g., due to disability or ESRD)
  - Rules allow <65 retirees to be treated as having same cost as 65+ retirees
  - Similar adjustments apply to plans covering employees in high-risk professions (next slide)
High-Risk Professions

- Same increases ($1,650/$3,450) apply to individuals covered under a plan sponsored by an employer the majority of whose employees covered under the plan are in a high-risk profession.
- High risk = install/repair telecommunication or electrical lines; police; firefighters; first responders/paramedics; fishing; construction; agricultural; mining; forestry; longshoreman.
- No double dip if retirees; no health care cost or age/sex adjustments.
- Rule appears to apply to everyone in the plan, even those who aren’t in a high-risk job.
How Would the Tax Work?

- Next RFI from IRS will solicit comments on tax remittance process with IRS
  - Tax accrues on a monthly basis
  - ACA provides penalties for underreporting tax liability
    - Including an employer undervaluing an insured plan that it reports to the carrier
      - Liable for tax, plus interest and penalties
  - If multiple coverages, then tax must be apportioned to each
    - Examples on next two slides
How Would the Tax Work?

Example A
An employee chooses family coverage under an insured employer-sponsored plan.

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total value of employee’s healthcare coverage</td>
<td>$28,500</td>
</tr>
<tr>
<td>Threshold for family coverage in 2018</td>
<td>-$27,500</td>
</tr>
<tr>
<td>Amount subject to the excise tax</td>
<td>$1,000</td>
</tr>
</tbody>
</table>

The employer reports $1,000 as taxable to the insurer, which remits the 40 percent tax ($400) to the Internal Revenue Service.
How Would the Tax Work?

Example B
An employee elects family coverage under an insured employer plan with an HRA. The employee also contributes to a health FSA.

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Value of employee’s healthcare coverage</td>
<td>$25,000</td>
</tr>
<tr>
<td>Value of employee’s HRA</td>
<td>$2,000</td>
</tr>
<tr>
<td>Employee contribution to the flexible spending arrangement</td>
<td>+$2,500</td>
</tr>
<tr>
<td>Total value of employee’s healthcare coverage</td>
<td>$29,500</td>
</tr>
<tr>
<td>Proposal’s threshold for family coverage in 2013</td>
<td>-$27,500</td>
</tr>
<tr>
<td><strong>Amount subject to the excise tax</strong></td>
<td><strong>$2,000</strong></td>
</tr>
</tbody>
</table>

The employer reports the taxable amounts:

- $1,695 to the major medical insurer ($2,000 x $25,000/$29,500)
- $136 to the administrator of the HRA ($2,000 x $2,000/$29,500)
- $169 to the administrator of the spending account ($2,000 x $2,500/$29,500)

The insurers and the administrator calculate and remit the taxes. If the employer administers the FSA and HRA, the employer has to calculate and remit the taxes.
Implications/Issues

ACTIVE EMPLOYEES:
Raise deductibles and copays
Eliminate Health FSAs and Pretax HSA Contributions
On-site clinic impact?

PRE-65 RETIREE MEDICAL:
EMPLOYERS CONTINUE TO EXIT

REVIEW YOUR CBAS FOR
UNION EMPLOYEES

LEGISLATIVE FIX NEEDED
Where does Congress get the money?
Final Thoughts

- H.R., 2050, “Middle Class Health Benefits Tax Repeal Act of 2015”
  - Bill would repeal the Cadillac tax (104 co-sponsors)
  - No companion bill yet in Senate

- Resources available on Lockton.com
  - White paper—Looking at Lockton’s book of business from BenefitPoint, we project the likelihood of the medical plan’s funding rates alone triggering the Cadillac Tax at different trend assumptions. This is illustrated for 2018, 2023, and 2028.
  - Alert on IRS’s RFI—The Department of Treasury and the Internal Revenue Service (IRS) issued a request for information (RFI) on a variety of issues related to the excise tax on high cost employer coverage that will apply in 2018.
New Guidance on Maximum Out-of-Pocket Limits
ACA Cost Sharing Limits (aka out-of-pocket limits)

- A non-grandfathered plan cannot have an out-of-pocket (OOP) limit higher than the dollar amount set for each year.

<table>
<thead>
<tr>
<th>Coverage Unit</th>
<th>Maximum OOP Limits ACA Mandate</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>2015 Plan Years</strong></td>
<td></td>
</tr>
<tr>
<td>Self-Only</td>
<td>$6,600</td>
</tr>
<tr>
<td>Other</td>
<td>$13,200</td>
</tr>
<tr>
<td><strong>2016 Plan Years</strong></td>
<td></td>
</tr>
<tr>
<td>Self-Only</td>
<td>$6,850</td>
</tr>
<tr>
<td>Other</td>
<td>$13,700</td>
</tr>
</tbody>
</table>

- All cost-sharing (deductibles, co-pays, coinsurance) for in-network essential health benefits (EHBs) must count against the limit.
  - Employer plans still are not required to cover all EHBs, but to the extent that an employer plan does so, cost sharing cannot exceed the limit for the year.
ACA Cost Sharing Limits (aka out-of-pocket limits)

- Plan may allocate the maximum OOP limit among various types of plan benefits
  - Example of compliant allocation for 2015:
    - OOP limit for prescription drugs: $2,600 (self only)/$ 5,200 (other)
    - OOP limit for all other expenses: $4,000 (self only); $8,000 (other)

- Total dollar amount of plan’s OOP limits cannot exceed maximum for the year
  - Example of non-compliant allocation for 2015:
    - OOP limit for prescription drugs:
      - $3,000 (self only)/$ 6,000 (other)
    - OOP limit for all other expenses:
      - $4,000 (self only); $8,000 (other)
      - Total OOP limit: $7,000 (self only); $14,000 (other)

- Allocation remains permitted for 2016 and future years, until changed
New for 2016: Self-Only Maximum OOP Limit Applies to All

- HHS, DOL and IRS “clarified” that the self-only maximum OOP limit applies to every enrollee – even those enrolled in family coverage.

- Agencies also clarified that this rule won’t apply until plan years starting in 2016.
  
  **Example:**
  
  - Plan’s OOP limits are $6,000 (self only)/$12,000 (other).
  - If the plan’s self only OOP limit is embedded, a family member who incurs $6,000 in cost sharing will reach his individual OOP limit, even if the family OOP limit is not met.
  
  - If the plan’s self only OOP limit is non-embedded, the only way for any family member to reach OOP limit is for family members’ cost sharing to total $12,000.
    
    For 2016, this plan does not comply with the ACA maximum OOP limit, as clarified, because an individual family member might have to incur $12,000 in cost sharing to reach OOP limit.
Required Changes for 2016 Plan Years

- None, we hope – ongoing efforts to overturn the clarification
  - Probably must assume those won’t work and that clarification will apply

- And many plans already have embedded OOP limits that need not be changed

- For a plan like the one with the $6,000/$12,000 non-embedded OOP limit, here are two potential fixes:

<table>
<thead>
<tr>
<th>Design Option</th>
<th>Plan Change</th>
<th>Limit for Self-Only Coverage</th>
<th>Limit for Family Coverage</th>
<th>Embedded Limit for Each Family Member</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Embed Out-of-Pocket Limit</td>
<td>$6,000</td>
<td>$12,000</td>
<td>$6,000</td>
</tr>
<tr>
<td>2</td>
<td>Embed Out-of-Pocket Limit</td>
<td>$6,000</td>
<td>$12,000</td>
<td>Any amount ≤$6,850</td>
</tr>
</tbody>
</table>

- OOP limit for individual family members need not match the plan’s self-only OOP limit – just needs to be no greater than $6,850
Most of the plans that will need to make changes for 2016 are intended to qualify as high-deductible health plans (HDHPs).

- HDHP coverage is required for an individual to be eligible for health savings account (HSA) contributions.
- HDHPs are subject to an additional set of rules on OOP limits, and must meet BOTH sets of requirements (ACA and HDHP qualifying).
- Lower dollar maximums on OOP limits are required for HDHPs.

Previously, complying with both was easy enough – HDHPs just needed to meet the lower HDHP qualifying limits.
- For 2016 plan years, they need to comply with the clarification, which creates confusion.

### Coverage Unit

<table>
<thead>
<tr>
<th></th>
<th>2015 Plan Years</th>
<th>2016 Plan Years</th>
</tr>
</thead>
<tbody>
<tr>
<td>Coverage Unit</td>
<td>Maximum OOP Limits HDHP Rules</td>
<td>Maximum OOP Limits ACA Mandate</td>
</tr>
<tr>
<td>Self-Only</td>
<td>$ 6,450</td>
<td>$ 6,600</td>
</tr>
<tr>
<td>Other</td>
<td>$12,900</td>
<td>$13,200</td>
</tr>
<tr>
<td>Self-Only</td>
<td>$ 6,550</td>
<td>$ 6,850</td>
</tr>
<tr>
<td>Other</td>
<td>$13,100</td>
<td>$13,700</td>
</tr>
</tbody>
</table>
ACA Maximum OOP Limits Collide With HDHP Requirements

- HDHP qualifying rules do not require OOP limits to be embedded or non-embedded, but often require non-embedded deductibles
  - If self only deductible is lower than the HDHP qualifying minimum family deductible ($2,600 for 2016), then the deductible must be non-embedded
  - Industry practice has been that deductibles and OOP limits are either both embedded or both non-embedded
  - So, HDHPs with relatively low deductibles are the plans most likely to have non-embedded OOP limits and most likely to need amendment to comply
    - To keep their relatively low deductibles, these HDHPs need to continue to have non-embedded deductibles
    - BUT the clarification will require many of them to adopt some form of embedding for their OOP limits
    - Unclear whether industry will offer or administer coverage with a non-embedded deductible and embedded OOP limit
# Summary of Limits that Meet Both Rules

<table>
<thead>
<tr>
<th>Design</th>
<th>Plan Provision</th>
<th>Limit for Self-Only</th>
<th>Limit for Family</th>
<th>Embedded Limit for Each Family Member</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Non-Embedded Deductible</td>
<td>≥$1,300 &amp; ≤$6,550</td>
<td>≥$2,600 &amp; ≤$13,100</td>
<td>N/A</td>
</tr>
<tr>
<td></td>
<td>Embedded Out-of-Pocket Limit</td>
<td>≤$6,550 &amp; ≥$1,300</td>
<td>≤$13,100 &amp; ≥$2,600</td>
<td>≤$6,850 &amp; ≥$2,600</td>
</tr>
<tr>
<td>2</td>
<td>Embedded Deductible</td>
<td>≥$1,300 &amp; ≤$6,550</td>
<td>≥$2,600 &amp; ≤$13,100</td>
<td>≥$2,600 &amp; ≤$6,850</td>
</tr>
<tr>
<td></td>
<td>Embedded Out-of-Pocket Limit</td>
<td>≤$6,550 &amp; ≥$1,300</td>
<td>≤$13,100 &amp; ≥$2,600</td>
<td>≤$6,850 &amp; ≥$2,600</td>
</tr>
<tr>
<td>3</td>
<td>Embedded Deductible</td>
<td>≥$1,300 &amp; ≤$6,550</td>
<td>≥$2,600 &amp; ≤$13,100</td>
<td>≥$2,600 &amp; ≤$6,850</td>
</tr>
<tr>
<td></td>
<td>Non-Embedded Out-of-Pocket Limit</td>
<td>≤$6,550 &amp; ≥$1,300</td>
<td>≤$6,850 &amp; ≥$2,600</td>
<td>N/A</td>
</tr>
<tr>
<td>4</td>
<td>Non-Embedded Deductible</td>
<td>≥$1,300 &amp; ≤$6,550</td>
<td>≥$2,600 &amp; ≤$13,100</td>
<td>N/A</td>
</tr>
<tr>
<td></td>
<td>Non-Embedded Out-of-Pocket Limit</td>
<td>≤$6,550 &amp; ≥$1,300</td>
<td>≤$6,850 &amp; ≥$2,600</td>
<td>N/A</td>
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