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To: Board of Trustees, U.A. Local 467 Health and Welfare Plan ("Plan")

From: Richard Grosboll and Lois Chang, Trust Counsel

Re: **IRS Preliminary Guidance on Cadillac Tax Requirement**

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Recently, the IRS released Notice 2015-16 ("Notice") on the Cadillac tax requirement. The IRS clarified that the Initial Notice does not provide guidance upon which Insurers and Plan Sponsors may rely on. Instead, the Notice is intended to inform the public of its process of developing future regulatory guidance regarding the Cadillac tax on high cost plans. The IRS anticipates issuing a couple of other notices before publishing the Proposed Rules. **We provide the following for informative purposes only. No Action is Necessary yet given that the Notice does not provide definitive guidance. As you will see on the examples reflected on the second page, we believe this Plan is not even close to having the Cadillac tax assessed.**

### **I. Background of Code Section 4980I Cadillac Tax**

Beginning in 2018, Internal Revenue Code Section 4980I will impose a 40% excise tax on any excess benefit (excess aggregate cost of applicable coverage) provided to an employee, former employee (ex. retiree, disabled), spouse or other primary insured person. Insured plans would use the premium amount (and other costs, most likely), while self-insured plans (such as this Plan) would use methods similar to determining the COBRA rates to determine the cost of applicable coverage.

- **\$27,500 Limit for Multiemployer Plans.** For 2018, the statutory annual dollar limit per employee for self-only coverage is \$10,200 and \$27,500 for other-than-self only coverage ("family coverage"), subject to various adjustments for qualified retirees (retirees age 55 – 64 not eligible for Medicare), employees engaged in high-risk jobs, and age & gender. **Multiemployer plans must use the family coverage threshold amount of \$27,500, but which is increased by \$3,450 to \$30,950 because of the adjustment for anticipated additional costs incurred by a plan whose majority of covered workers are in high risk professions (i.e., construction workers) and electricians pursuant to IRS guidelines.**
- **Reliance on Method for Determining COBRA.** The IRS' primary focus on the costs used in determining a Plan's COBRA rates is ironic given that the IRS have provided very little guidance to Plan determining such rates. In essence, the primary guidance issued in the past has been that Plans have been required to use "good faith" in determining the COBRA rates. We are unaware of court cases challenging the manner in which COBRA premiums have been set.
- **Actuarial or Past Cost Method.** Congress permitted two methods for self-insured plans to compute the COBRA applicable premium—the actuarial basis method or the past cost method. Not surprisingly, the actuarial basis method provides that for a self-insured plan, the COBRA applicable premium is equal to a reasonable estimate of the cost of providing coverage for similar situated beneficiaries that is determined on an actuarial basis, and takes into account such as factors that the Secretary of the Treasury prescribes. But, the Secretary has never established those factors.

### **II. Important Points from Notice**

The Notice addresses certain subjects under the Cadillac Tax that the IRS anticipates to address in future proposed regulations. Below are the provisions that may apply to this Plan:

- **DENTAL & VISION BENEFIT EXCLUSION.** The IRS anticipates that the costs of stand-alone, insured dental and vision benefits will be excluded in determining whether the Cadillac tax is assessed. However, the IRS is considering whether to extend a similar exclusion to self-funded dental and vision coverage arrangements that qualify as an excepted benefit (meaning regardless of whether dental and vision benefits are offered on a stand-alone basis or bundled with medical benefits, participants are given the right to opt-out of dental and vision coverage). **This Plan can exclude its vision benefits since those benefits are separately insured through VSP.**

- **SIMILARLY SITUATED INDIVIDUALS/ENROLLED COVERAGE.** The IRS anticipates that the cost of applicable coverage will be based on the health coverage in which the employee is actually enrolled. The IRS is also considering ways in which plans and insurers can classify employees as similarly situated employees for purposes of determining cost by grouping similarly situated employees separately based on the particular benefit package they are enrolled in (e.g., **employees enrolled in HMO option vs. employees enrolled in PPO option**), then subdividing that group based on mandatory disaggregation rules (e.g., self-only coverage vs. family coverage)
- **SELF-INSURED PLANS.** The cost of applicable coverage is determined under rules similar for determining the COBRA costs for the Plan as noted above (**Actuarial Basis or the Past Cost Method**). It is anticipated that the IRS rules will determine what costs can be used, such as claims, premiums for stop-loss insurance, administrative expenses, and reasonable overhead expenses. Plans must use the Actuarial basis method unless the plan elects the Past Cost method and is eligible to use such method. In addition, the IRS is considering whether to adopt a certain time period (such as 5 years) that prohibits insurers and plans from switching between the two methods.

Below examples are for illustrative purposes, based on current anticipated costs for the Plan's benefits:

<b>KAISER HMO BENEFITS</b>			
<u>Monthly Premiums</u> \$1,276	<u>Total Annual Premiums</u> \$1276 X 12 months = \$15,312		
<u>Average Annual cost per covered person = \$15,312</u>			
<b>The above annual amount per covered person under the HMO option would not exceed the annual limit.</b>			
<b>SELF-FUNDED PPO MEDICAL BENEFITS</b>			
<b>(1) Actuarial Method.</b> To illustrate, this Plan's 2015 monthly COBRA rates were:			
<u>Full COBRA (Actives)</u> \$1,920 (COBRA Rate) \$1,920 x 12 mos = <u>\$23,040</u>	<u>Core COBRA (Actives)</u> \$1,780 (COBRA Rate) \$1,780 x 12 mos = <u>\$21,360</u>	<u>COBRA (Early Retirees)</u> \$990 (COBRA Rate) \$990 x 12 mos = <u>\$11,880</u>	<u>COBRA (Medicare Retirees)</u> \$395 (COBRA Rate) \$395 x 12 mos = <u>\$4,740</u>
<u>Average Annual cost per covered person = \$14,318</u>			
<b>Past Cost Method.</b> To illustrate, based on this Plan's 2013 Form 5500 costs for benefits were:			
<u>Total claims Paid</u> \$8,729,570	<u>Stop Loss</u> \$700,000	<u>#Participants</u> 500	<u>Admin./Overhead expenses</u> \$799,613
<b>(2) Annual cost per covered person = \$20,458</b> or (\$8,729,570 + \$700,000 + \$799,613 divided by 500)			
<b>The above annual amounts per covered person (for similarly situated individuals) under the PPO option, each would not exceed the ACA Annual limit (\$30,950).</b>			

*23,040  
17,800  
also  
stop losses*

- **EMPLOYEES WITH SELF-ONLY & FAMILY-COVERAGE.** The IRS is considering what approach to adopt in a situation where an employee has one type of coverage that is self-only and another type of coverage that is family coverage (ex., employee has self-only medical coverage and supplemental HRA coverage that covers the family). One approach would depend on whether the employee's primary medical coverage is self-only or family coverage (meaning the self-only or family coverage that accounts for the majority of the aggregate cost of applicable coverage). Another approach would apply a composite dollar limit determined by prorating the dollar limits for each employee according to the ratio of the cost for self-only coverage and cost for family coverage. **However, the IRS indicated that self-only coverage under a Multiemployer plan would be treated as family coverage (\$27,500 limit).**
- **ADJUSTMENT (INCREASES TO ANNUAL LIMIT).** The IRS is seeking comments on applying adjustments for retirees age 55 and older not eligible for Medicare), individuals who participate in a plan whose majority of employees enrolled are engaged in high risk professions (i.e., **electricians**, firefighters, paramedics, first-responders, longshore workers, and **individuals engaged in the construction**, mining, agricultural, forestry, and fishing industries), and the age and gender characteristics of an employer's workforce. For instance, how the plan determines that an employee is not eligible for enrollment in Medicare; how the plan determines whether the majority of employees covered by the plan are engaged in a high-risk profession; and whether a safe harbor should be adopted for employee populations with age and gender characteristics different from those of the national workforce.

We hope this summary provides some insight as to the most likely approach the IRS will take when it eventually releases its proposed rules on the Cadillac tax. Once the Actual Guidance and Proposed Rules are released we will provide you with more information. If you have any further questions, please contact us.