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Excise Tax on High-Cost Employer-Sponsored Health Coverage: What Counties Need to Know

NACo National Association of Counties

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Overview

Since the passage of the Patient Protection and Affordable Care Act (ACA), much of the health care landscape has changed particularly for employers. One ACA provision which may significantly impact counties is the excise tax on high cost employer-sponsored health coverage.[1] Set to take effect in 2018, the provision states:

> If (1) an employee is covered under any applicable employer-sponsored coverage of an employer at any time during a taxable period, and (2) there is any excess benefit with respect to the coverage, there is hereby imposed a tax equal to 40 percent of the excess benefit.[2]

Employers, insurance companies and/or plan administrators for health plans exceeding the thresholds of $10,200 for individual coverage and $27,500 for family coverage will pay the tax. While federal regulations for this excise tax have not yet been released, many of the nation's 3,069 counties are currently assessing and analyzing how the excise tax may impact their county budget and health plans. Sonoma County, Calif., Pinellas County, Fla., and Ontario County, N.Y. have done initial assessments and found their liability in the first year (2018) may be $3.4 million, $410,000 and $812,000, respectively. Some counties such as Cochise County, Ariz., Genesee County, N.Y., and Greene County, N.Y. have found their liability will differ over time for various employee categories. Depending on the premium tiers, Cochise County expects to pay an excise tax between 2021 and 2028 for its active employees and between 2018 and 2025 for its retirees. Assuming a 5 percent increase in health care costs, Genesee County does not expect to have a tax liability for at least 4 to 5 years. Of Greene County's 6 collective bargaining contracts, one contract is currently in excess of the 2018 thresholds and the remaining contracts are expected to surpass the thresholds by 2018.

With the excise tax costs expected to rise over the years as health care costs increase, the burden on county budgets may be significant and directly affect employees and taxpayers. It is imperative counties begin to assesses their liability for this tax as soon as possible and develop a strategic solution for 2018 and beyond. This issue brief aims to provide an overview of the excise tax and considerations for counties as they determine their potential tax liability.

Approximately 6 percent of the health plans offered by counties would have a tax liability if the excise tax was implemented in 2014, according to the NACo County

1 The excise tax on high-cost health insurance is also commonly referred to as the "Cadillac Tax."

2 26 U.S. Code § 4980I(a) Imposition of Tax. Available at: http://www.gpo.gov/fdsys/pkg/USCODE-2011-title26/pdf/USCODE-2011-title26-subtitleD-chap43-sec4980I.pdf

Health Benefits Study.[3] **However, a county's tax liability and the magnitude of the liability may be strongly affected by health insurance costs trend rates.** These rates are influenced by factors such as price inflation, changes in cost due to government regulations on benefits and plans (e.g., coverage of dependent children to the age of 26, removal of lifetime and annual limits, etc.), utilization of medical services and new technology and treatments.

COUNTIES MAY OBSERVE THAT THE TOTAL CHANGE IN THEIR HEALTH PLAN COSTS MAY BE SIMILAR TO THE HEALTH CARE COSTS TREND RATES, BUT THEY ARE NOT THE SAME. THE CHANGE IN HEALTH PLAN COSTS ARE DETERMINED BY THE GROUP DEMOGRAPHICS (SUCH AS AGE), EMPLOYEE CONTRIBUTIONS, GOVERNMENT TAXES AND FEES, ADMINISTRATIVE FEES AND CHANGES TO THE BENEFITS PLAN. IT IS POSSIBLE THAT IN SOME YEARS THE NET ANNUAL CHANGE IN PLAN COSTS WILL DIFFER FROM THE HEALTH CARE COST TREND RATES.

While national health care costs have increased by about 4 percent in the last year,[4] the Centers for Medicare and Medicaid Services expects health spending to grow at an average rate of 5.8 percent from 2012 to 2022.[5] Furthermore, health care insurance costs are projected to increase by 10 percent in the western region of the United States in contrast to a 5.8 percent growth in the south.[6] These regional rates may vary substantially due to the limited sample size in the study.

The increasing costs of health care and the excise tax liability will impact county budgets and potentially health coverage benefits. These taxes may impact how counties provide services and fulfill their responsibilities.

RAMSEY COUNTY, MINN.

Population: 508,640 (2010 Census)

Health Plan Demographics: There are 3,156 employees and 436 Early Retirees (<65 years old) with medical coverage. Of those enrolled, 2,166 have single coverage and 1,426 have family coverage. There are approximately 7,600 enrollees.

2018 Projected Tax Liability: $800,000 (single coverage)

While Ramsey County expects a penalty of about $800,000 for single coverage, it does not expect to have a liability on its family coverage. As a result of the tax on self-coverage, monthly premiums will rise by $30.60. These projections are based on a rate cap guarantee through 2017 and an estimated 10 percent rate increase in 2018. Ramsey County plans to continue assessing its liability yearly and work with its labor unions to regularly make gradual plan design changes to control costs and address the county's excise tax liability.

PEORIA COUNTY, ILL.

Population: 186,494 (2010 Census)

Health Plan Demographics: 593 employees and 90 retirees

2018 Projected Tax Liability: Over $2 million

A self-funded county, Peoria County's claim costs are below the national average. This has enabled the county to currently keep their premiums at the same level as in 2007. This is a result of its wellness program, Live Well, and its Prevention Plan. Peoria County has strategically built its fund reserves to offset the cost of the tax and any other ACA-related taxes and fees to minimize the impact on its employees with regards to plan design.

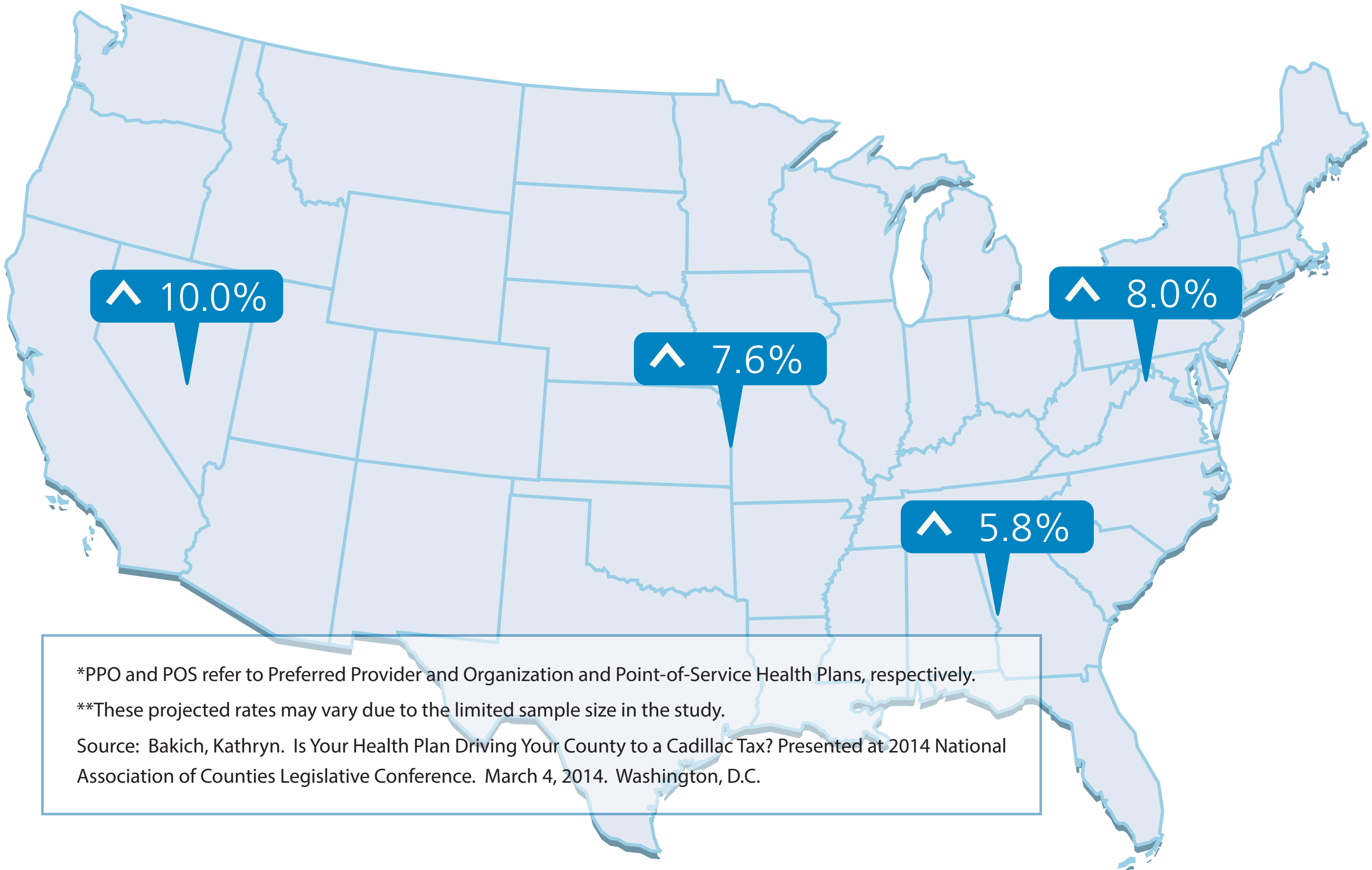
3 Istrate, Emilia, Kirk Heffelmire and Molly Longstreth. County Health Benefits Study 2014. Washington, D.C.: National Association of Counties. Available at: http://www.naco.org/research/Pages/county-health-benefits.aspx

4 Kaiser Family Foundation. Assessing the Effects of the Economy on the Recent Slowdown in Health Spending. April 22, 2013. Available at: http://kff.org/health-costs/issue-brief/assessing-the-effects-of-the-economy-on-the-recent-slowdown-in-health-spending-2/

5 Centers for Medicare and Medicaid Services. National Health Expenditure Projections 2012-2022 Forecast Summary. Available at: http://www.cms.gov/Research-Statistics-Data-and-Systems/Statistics-Trends-and-Reports/NationalHealthExpendData/downloads/proj2012.pdf

6 Bakich, Kathryn. Is Your Health Plan Driving Your County to a Cadillac Tax? Presented at 2014 National Association of Counties Legislative Conference. March 4, 2014. Washington, D.C.

FIGURE 1: 2014 REGIONAL VARIATIONS IN HEALTH CARE COSTS FOR PPO AND POS* HEALTH PLANS**



*PPO and POS refer to Preferred Provider and Organization and Point-of-Service Health Plans, respectively.

**These projected rates may vary due to the limited sample size in the study.

Source: Bakich, Kathryn. Is Your Health Plan Driving Your County to a Cadillac Tax? Presented at 2014 National Association of Counties Legislative Conference. March 4, 2014. Washington, D.C.

PINELLAS COUNTY, FLA.

Population: 916,542 (2010 Census)
Health Plan Demographics: 7,477 enrollees
2018 Projected Tax Liability: $410,000

The total health plan costs for Pinellas County employees are currently $47.8 million and the county pays about $40 million. Assuming there are no changes to the employee health plan, the county expects there to be a 1 percent (about $410,000) impact on its county budget in 2018. By 2024, the impact to the county budget will double to 2 percent (or $1.5 million). By 2028, the county expects to pay approximately $3.3 million in taxes.

Pinellas County is exploring various strategies including controlling their claims cost and enhancing their award-winning wellness program as potential methods for reducing their liability. The county has partnered with a clinic management vendor and the local health system to provide access to low-cost, high-quality care through an employee health center. Pinellas County also plans to heavily integrate the employee health center into all aspects of its health, wellness and benefits programs by including resources on nutrition, employee assistance programs, stress management and in-person health coaching and disease management.

Once counties have assessed their liability over the course of several years, ways to mitigate their liability should be explored. This presents counties with an opportunity to strategically address their liability and develop (a) solution(s) that is appropriate for their county. Cost savings are not realized overnight and may require time to demonstrate.

Mitigation strategies may include counties assessing plan designs, implementing disease management and wellness programs and reviewing vendor administrative costs. For example, the Wisconsin Counties Association – Group Health

Trusts suggests counties review their plan networks as this factor may have the largest impact on costs. Moving to a narrower network may drive costs lower while providing the same benefits to employees. In addition, implementing wellness programs may help to improve employee health and ultimately lower costs, but these outcomes will not be achieved overnight. Another strategy is to consider retiree health care costs. There are some jurisdictions that have assessed whether moving their retirees to Medicare Advantage plans or an insurance marketplace are appropriate steps for maintaining health care coverage while managing their county's budgets.

HERKIMER COUNTY, N.Y.

Population: 64,519 (2010 Census)

Health Plan Demographics: 403 employees, 538 contracts

2018 Projected Tax Liability: $37,430 for 104 single contracts and $35,174 for the 43 family contracts

Herkimer County currently has 3 insurance rate plans: single, one plus one and family. To delay the county's tax liability, Herkimer County is considering eliminating its one plus one rate. Enrollees in the one plus one rate would then be covered under the family rate. Combining the two rate plans lowers the family coverage premiums costs and ultimately delays the tax liability for a few years.

NIAGARA COUNTY, N.Y.

Population: 216,469 (2010 Census)

Health Plan Demographics: Of 1,488 active employees, there are 1,236 active enrollees and 937 retirees enrolled.

2018 Projected Tax Liability: Over $1.4 million for legacy traditional plan retirees

Since Niagara County has several employee health plans in place, its liability for each plan will differ over the course of several years. Niagara County expects to have a liability of over $5.1 million for all of its health plans by 2022. However, the county projects that its self-funded plans for some active employees and retirees will exceed the threshold limits in 2020. The liability for its active employees and retirees enrolled in the county's redesigned health plans will be minimal prior to 2022. In the past, Niagara County has offered monetary incentives to retirees enrolled in its higher-costs traditional plan option to move to a lower-cost Medicare Passport option with claim risks transferred to an insured plan. Currently, the county is using the Retiree Drug Subsidies Program* to lower costs and is reviewing its prescription drug coverage options for retirees enrolled in its traditional plan to help reduce prescription drug and premium costs.

*The Retiree Drug Subsidy Program is a Centers for Medicare and Medicaid Services program that reimburses health plan sponsors (such as local governments, private employers and unions) for a portion of their expenses related to retiree prescription drug benefits while the Medicare-eligible retirees retain their current health plans. More information available at: http://rds.cms.hhs.gov.

TODD COUNTY, MINN.

Population: 24, 895 (2010 Census)
Health Plan Demographics: 200 FTEs
2018 Projected Tax Liability: $45,000 to $100,000

Depending on health care trend rates, Todd County's projected liability ranges from $45,000 to $100,000 in 2018. The county plans to negotiate a revision of its benefits package to reduce its tax liability.

"MANY TEXAS COUNTIES ARE BEGINNING TO TAKE STEPS TO REDUCE THEIR EXPOSURE TO THE AFFORDABLE CARE ACT EXCISE TAX. THESE STEPS INCLUDE REVIEWING CURRENT HEALTH PLAN DESIGNS AND PROMOTING WELLNESS PROGRAMS. THERE IS, HOWEVER, UNCERTAINTY REGARDING THE NEXT STEPS THEY SHOULD TAKE BECAUSE THE RULES FOR ADMINISTERING THE TAX HAVE NOT BEEN PROMULGATED."

QUINCY QUINLAN, DIRECTOR, HEALTH AND BENEFITS SERVICES DEPARTMENT, TEXAS ASSOCIATION OF COUNTIES

BERKS COUNTY, PA.

Population: 411,442 (2010 Census)
Health Plan Demographics: 4,149 enrollees
2018 Projected Tax Liability: $1,215,684

Berks County is self-insured and projects its liability will increase to $3,591,493 by 2022. Over the course of 5 years, the county anticipates paying a minimum total of $11,649,499. To address the liability, Berks County will be reviewing its health, prescription drug and wellness programs. It will also work with its employee union to address the tax.

"THE APPLICATION OF THE EXCISE TAX TO LOCAL GOVERNMENT POSES A SERIOUS FINANCIAL AND MANAGERIAL THREAT IN MANY PARTS OF THE COUNTRY. FOR MANY YEARS, ONE OF THE MAJOR TOOLS USED TO ATTRACT AND RETAIN HIGH-QUALITY EMPLOYEES HAS BEEN THE EXISTENCE OF TOP-SHELF BENEFITS – CHIEF AMONG THOSE HAS ALWAYS BEEN QUALITY HEALTH INSURANCE FOR THE EMPLOYEE AND HIS OR HER FAMILY.

IT IS CLEAR THAT LOCAL OFFICIALS MAY BE FACED WITH THE VERY REAL POSSIBILITY OF REDUCING THE QUALITY OF HEALTH INSURANCE IN ORDER TO AVOID THE FINANCIAL IMPACT OF THE EXCISE TAX. SUCH A CHANGE WILL, UNQUESTIONABLY, IMPACT OUR ABILITY TO RETAIN THE BEST-OF-THE-BEST IN COURTHOUSES ALL OVER OUR COUNTRY.

IN THE LONG RUN, IT WILL BE THE TAXPAYERS WHO WILL SUFFER IF THE EXCISE TAX PRODUCES A REDUCTION IN THE QUALITY OF HEALTH CARE FOR LOCAL GOVERNMENT EMPLOYEES."

SONNY BRASFIELD, EXECUTIVE DIRECTOR, ASSOCIATION OF COUNTY COMMISSIONS OF ALABAMA

Frequently Asked Questions

Question 1: What is the Excise Tax on High Cost Employer-Sponsored Health Coverage and when does it go into effect?

The total cost of health coverage is the employer cost plus the employee cost. The total cost also includes the cost of any savings account arrangements such as health reimbursement arrangements and flexible spending accounts.

The excise tax is a permanent 40 percent tax placed on the aggregate value of health insurance benefits exceeding $10,200 for individual coverage and $27,500 for family coverage as of january 1, 2018.

What is included in the aggregate value of a health plan?

- Employer + employee premiums for coverage
- The COBRA (Consolidated Omnibus Budget Reconciliation Act of 1985) rate for the self-insured
  - » Individual Account Arrangements
  - » Any salary reduction contributions to flexible spending
  - » The value of the employer contribution to the health savings accounts
  - » The applicable premium for health coverage provided through the health reimbursement account
- Onsite medical clinic value
- Retirees in the employee-sponsored health plan

Source: 26 U.S. Code § 4980I (c) Liability to pay tax. Available at: http://www.gpo.gov/fdsys/pkg/USCODE-2011-title26/pdf/USCODE-2011-title26-subtitleD-chap43-sec4980I.pdf

Question 2: How is the Tax calculated?

Excise Tax Formula:	40% x Amount Exceeding Threshold = Excise Tax Per Employee
How to Calculate the Amount Exceeding Threshold Value:	Value of Health Plan Coverage - [Threshold x Health Cost Adjustment Percentage*] = Amount Exceeding Threshold Value
Assumptions	In this 2018 scenario, the self-coverage value of a plan is $12,200, there are 500 employees in 2018 and no health cost adjustment has been made.
Example	0.4 x ($12,200 - $10,200) = $800 tax per employee
Aggregate Tax Formula	Tax liability x Number of Employees = Total Tax Liability
Aggregate Tax Value	$800 x 500 employees = $400,000

Note: Please see question 6 for more information about the threshold dollar amount.

**The value of the health cost adjustment is unknown as federal regulations have not yet been released.*

Source: 26 U.S. Code § 4980I (b)(3)(C) Applicable dollar limit. Available at: http://www.gpo.gov/fdsys/pkg/USCODE-2011-title26/pdf/USCODE-2011-title26-subtitleD-chap43-sec4980I.pdf

Question 3: What is the purpose of this tax?

The excise tax was included in the ACA to help to finance the expansion of health coverage. In addition, the tax is expected to curtail the growth of premiums and health care costs.

Question 4:

Who does it apply to?	Who pays?
• Self-funded plans • Fully insured plans	• The plan administrator (this is usually the employer.) • The health plan issuer

Note: While the employer or plan issuer may be responsible for paying the excise tax, the costs may be passed onto the employee through higher premiums, deductibles and/or copayments.

Question 5: Are there any exemptions?

Standalone dental and vision plans, long-term care, disability income insurance, accident insurance and any other coverage with a separate contract of insurance, certificate or policy are excluded.[7]

7 26 U.S. Code § 4980I (b)(1)(B) Exceptions. Available at: http://www.gpo.gov/fdsys/pkg/USCODE-2011-title26/pdf/USCODE-2011-title26-subtitleD-chap43-sec4980I.pdf

Question 6: Will the threshold change over the course of time?

The threshold will change each year as it is indexed to the Consumer Price Index (CPI). In 2018 and 2019, it is indexed to the CPI plus 1 percentage point and solely to the Consumer Price Index in 2020 and subsequent years. There is an adjustment to the threshold based on age and gender. However, the law does not provide any details of the value of the adjustment. Furthermore, there are increased thresholds for (1) pre-Medicare retirees (i.e., individuals aged 55 and older who are covered by the employer and not Medicare eligible) and (2) if a majority of those in the plan are engaged in high-risk professions or are employed to repair or install electrical or telecommunication lines.

Who is considered a high-risk professional?

- **Law enforcement**
- **Fire protection**
- **Out-of-hospital emergency medical care, including emergency medical technicians, paramedics and first-responders**
- **Longshore work**
- **Construction**
- **Mining**
- **Agriculture (excluding food processing)**
- **Forestry**
- **Fishing industries**
- **Telecommunications, and**
- **Individuals retired from any of the aforementioned professions and was an employee for at least 20 years.**

Source: 26 U.S. Code § 4980I (f)(3) Employees engaged in high-risk profession. Available at: http://www.gpo.gov/fdsys/pkg/USCODE-2011-title26/pdf/USCODE-2011-title26-subtitleD-chap43-sec4980I.pdf

Question 7: What is the threshold for plans with a majority of employees engaged in high-risk professions?

The threshold increases by $1,650 for individual-coverage and by $3,450 for family coverage to $11,850 and $39,950, respectively.

Question 8: What is the penalty if employers or insurers undervalue their tax costs?

If employers or insurers underreport the value of the cost subject to the tax, the penalty will be equal to the excise tax that would have been owed plus the interest accrued from the date the tax should have been paid. This penalty may be waived by the Secretary of Treasury if the entity responsible for paying the tax makes the correction within 30 days or shows reasonable cause for undervaluing the tax penalty.[8]

Question 9: When will the federal government release more details about the excise tax?

It is unknown when the U.S. Department of Health and Human Services and the Internal Revenue Service will release regulations or actuarial guidance on the excise tax. When this information is available, it will be published in the Federal Register, which can be found at: https://www.federalregister.gov/.

Question 10: What is NACo's position on the excise tax?

NACo opposes the taxation of health insurance benefits and any new taxes that would apply to the health benefits counties provide to their employees.[9]

8 26 U.S. Code § 4980I (e) Penalty for failure to properly calculate excess benefit. Available at:
http://www.gpo.gov/fdsys/pkg/USCODE-2011-title26/pdf/USCODE-2011-title26-subtitleD-chap43-sec4980I.pdf

9 National Association of Counties. The American County Platform and Resolutions 2013-2014. p 130. Available at:
http://www.naco.org/legislation/Documents/American-County-Platform-and-Resolutions-2013-2014.pdf

What Should My County Do Now?

☐ **Did you determine your county's potential liability?**

Counties should project their excise tax liability using the formula and take into consideration health insurance trend rates for their geographic region.

☐ **Is your funding arrangement right for your county employee coverage?**

Counties should review whether being fully-insured or self-funded is appropriate for their employees. Although the health insurer is responsible for paying the excise tax for fully-insured employers, it is possible the costs may be passed on to employees. Self-funded plans may afford counties the opportunity to mitigate costs because it permits greater flexibility in plan design.

☐ **Have you reviewed your entire health plan?**

Reviewing the various components that contribute to the total health plan value may be an area to assess. Because health plan elements such as co-payments and deductibles are limited by the out-of-pocket maximum ACA provision, plan changes will need to occur over time. Some employers have ended employer contributions to tax-free flexible spending and health savings accounts to lower the taxable value of the plan. Counties with collective bargaining contracts will also need to begin discussions with the unions as early as possible to address any health plan redesigns that will minimize the county's liability.

☐ **Have you reviewed your benefit plan design?**

Counties may consider designing plans according to their employee demographics or based on value (i.e., a health plan that uses financial incentives to promote cost efficient services and consumer options). Furthermore, collective bargaining units may need to participate in the redesign of health plans.

☐ **Are retirees included in the county health plan?**

If your retirees are included in your health insurance plans, they will need to be included in the liability calculation.

☐ **Have you reviewed your health care coverage cost data?**

Reviewing data is critical to identifying ways to reduce liability. For example, a high prevalence of chronic conditions contributes to increased health care costs. Exploring wellness and/or disease management programs to address this costly area may help to mitigate costs over time.

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ABOUT NACO

The National Association of Counties (NACo) assists America's counties in pursuing excellence in public service by advancing sound public policies, promoting peer learning and accountability, fostering intergovernmental and public-private collaboration, and providing value-added services to save counties and taxpayers money. Founded in 1935, NACo provides the elected and appointed leaders from the nation's 3,069 counties with the knowledge, skills and tools necessary to advance fiscally responsible, quality-driven and results-oriented policies and services to build healthy, vibrant, safe and fiscally resilient counties. For more information about NACo, visit *www.naco.org*.

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