Employee Benefits Report

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Plan Now to Avoid the "Cadillac Tax"

An excise tax will apply to so-called "Cadillac" health plans starting in 2018. Will this affect your company's health plan?

When used as an adjective, "Cadillac" has come to mean something luxurious or extravagant. So when people discuss Cadillac health plans, they mean a high-cost or extravagant plan. Section 9001 of the Patient Protection and Affordable Care Act (ACA) imposes a non-deductible excise tax on high-cost plans, or so-called Cadillac health plans.

The tax has two purposes. First, it will raise some $80 billion over the next 10 years,

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This Just In…

Effective September 16, 2013, the IRS deems all legally married same-sex couples as married for federal tax purposes, regardless of whether their state of residence recognizes same-sex marriage. The ruling applies to couples legally married in any U.S. state or territory or foreign country. It does not apply to registered domestic partnerships, civil unions or similar formal relationships recognized under state law.

The ruling affects tax treatment of employer-sponsored qualified benefits. It does not require employers to provide spousal benefits if their state prohibits or does not recognize same-sex marriage. Same-sex spouses of employees will enjoy these

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estimates the Congressional Budget Office. Funds will help pay for tax credits that will subsidize health insurance coverage for lower- and middle-income Americans. Second, the tax will discourage high-cost health plans.

High-cost health plans, which often feature low or no deductibles and copayments, can insulate individuals from the true cost of their healthcare and encourage wasteful spending. And although it's true that rich health plans have become popular benefits for executives, many rank-and-file employees, particularly union workers, also have high-cost health plans. Rather than eliminating or capping the deductibility of high-cost employer-provided health plans, the Cadillac tax does an end-run around them. Regardless of whether you think the tax is a good idea or not, here's what you need to know about it.

When does it go into effect? The tax becomes effective in 2018 and tax periods thereafter.

Which health plans does it affect? Section 9001 applies to all employer-sponsored health coverage that is excludable from the employee's gross income under section 106, whether insured or not. This includes contributions to an employee's HSA (health savings account), health flexible spending account (FSA) or Archer MSA (medical savings account). For insured plans, it applies regardless of a plan's grandfather status.

Employer-sponsored health coverage for purposes of the tax does not include standalone dental or vision benefits, plans that cover only specified diseases (such as cancer insurance or "dread disease" insurance) or indemnity plans, such as hospital indemnity plans, that pay benefits according to a schedule.

Which amounts will be taxed? Section 9001 defines a high-cost plan on the basis of total premiums (or costs, for a self-insured plan). The law specifically states that "coverage shall be treated as applicable employer-sponsored coverage without regard to whether the employer or employee pays for the coverage" and that "coverage includes [the] employee-paid portion." It sets the "high-cost" threshold at $10,200 for single-only coverage and $27,500 for families for 2018. The threshold will adjust for cost of living increases in following years. The tax applies to any premium (or contribution) amount over the threshold, calculated on a monthly basis.

Who will pay the tax? The law requires the "coverage provider" to pay the tax. This means...

- For coverage under a group health plan: the health insurance issuer.
- For HSAs and MSAs: If the employer makes contributions, the employer.
- Other applicable coverage: the person that administers the plan's benefits.

Why should we consider the Cadillac tax now? Although the tax doesn't go into effect until 2018, many employers are starting to redesign their health plans to avoid cost increases that could trigger it. Employers with collective bargaining agreements may need time to negotiate major changes to their health benefits.

rights, if they apply to similarly situated opposite-sex spouses:

- **Ability to use pre-tax dollars to pay the employee's share of premiums**
- **Ability to exclude the value of employer-paid premiums from taxable income**
- **COBRA continuation privileges**
- **Death benefits under an employee's 401(k) plan**
- **A share of the employee's pension through a Qualified Domestic Relations Order (QDRO) in event of divorce**

Employees with same-sex spouses should update their W-4 to indicate their withholding preference: married-filing-separately or married-filing-jointly. Employers should review plan documents, employee manuals and other documents to ensure they reflect the changes.

The tax won't necessarily apply to only executive plans or plans with rich benefits. The Kaiser Family Foundation reports that the average annual premium for employer-sponsored family health coverage reached $5,884 this year, a 5 percent increase over 2012 costs. Even if health benefit costs continue to grow at this relatively low rate, premiums for single-only coverage under the average employer group plan will exceed $7,000. However, some groups pay much more for coverage that's not particularly rich, especially those in high-cost areas and those with older em-

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ployees or with a history of high claim costs. If healthcare inflation continues to exceed the general rate of inflation, even plans with average benefits could become subject to the tax.

In addition, employers will have the responsibility for determining whether the Cadillac tax will apply. They must "calculate for each taxable period the amount of the excess benefit subject to the tax" and notify the IRS and "each coverage provider." (In the case of a multi-employer plan, the plan sponsor will handle calculations and reporting.)

How can we avoid the Cadillac tax? Many employers are taking steps to control employee healthcare spending and keep health plan costs under the threshold. Strategies include:

- **Adopting a high-deductible health plan (HDHP).** High-deductible plans generally cost less than other medical plans. They also make employees more aware of their health expenditures, encouraging them to spend more wisely.
- **Adopting wellness and disease management programs.** Disease management programs can help control the cost of treating chronic disease, while wellness programs might prevent them.

For more information on the Cadillac tax and ways to avoid it, please contact us. ■

Long-Term Care Insurance: Not Just for the Elderly

The National Academy of Social Insurance reports that nearly 75 percent of baby boomers and seniors are concerned about paying for long-term care. Long-term care insurance can help.

Long-term care services differ from medical care. Long-term care providers render services that allow individuals to attain and maintain an optimal level of functioning when they cannot complete one or more of the basic activities of daily living (ADLs) without assistance. These are:

- Bathing
- Dressing
- Using the toilet
- Transferring (to or from bed or chair)
- Caring for incontinence
- Eating.

Not only elderly people need long-term care services. More than one-third (37 percent) of people receiving long-term care services are age 64 and younger. Disabilities, accidents and chronic conditions such as diabetes and high blood pressure can cause employees of any age to need long-term care.

The Cost of Care

Although long-term care services typically cost less than hospital care, they add up. Consider these average costs for long-term care services (in 2010):

- $205 per day or $6,235 per month for a semi-private room in a nursing home
- $229 per day or $6,965 per month for a private room in a nursing home
- $3,293 per month for care in an assisted

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living facility (for a one-bedroom unit)

- $21 per hour for a home health aide
- $19 per hour for homemaker services
- $67 per day for services in an adult day care center

Medical insurance (including Medicare) usually covers this type of care only after a covered hospitalization, and only for a limited time. Individuals with a fairly low income and savings may qualify for Medicaid, the federal public program that pays for most long-term care services. Other federal public programs, such as the Older Americans Act, and state-funded programs pay for long-term care services. To qualify for these programs, though, an individual typically must have a high level of disability and few assets. Long-term care insurance (LTCI) can help your employees get the care they need without spending down their assets.

Group LTCI

Group policies often offer coverage at cheaper rates than those available in the individual market. But very few insurers offer true group LTCI plans anymore, with guaranteed issue coverage for all eligible group members. Instead, they offer discounts on multi-life individual LTCI policies. Many employers will carve out LTCI benefits, paying premiums for executives and offering other employees coverage on a contributory or entirely voluntary (employee-paid) basis.

Most long-term care policies provide benefits on an indemnity or expense-incurred basis. An indemnity policy pays a fixed benefit, such as $200 per day you require care. An expense-incurred policy will pay your actual expenses up to a predetermined maximum amount per day, week or month. Policies will pay benefits for a specified maximum period, which can range from two years to lifetime. Better policies offer inflation protection, increasing benefits paid by a specified factor each year to prevent inflation from eroding the value of policy benefits.

Most policies have an elimination period, or a deductible in the form of a time period during which coverage does not apply. A 30-day deductible on nursing home care would mean coverage would start on the 31st day the insured person was in a nursing home.

Tax Treatment of LTCI

Employers can deduct premiums paid toward employees' LTCI policies as a business expense; employees do not have to include employer premium contributions in their taxable income. But the tax treatment for employee-paid LTCI premiums differs from that for other health benefits. While employees can pay their portion of premiums for group health, life and other qualified plans with pre-tax dollars, they must pay LTCI premiums with after-tax dollars.

Employees can deduct premiums they pay for themselves, their spouse or dependents as a medical expense if they itemize deductions on their Schedule A. Usually, only families with relatively high medical expenses can take a medical expense deduction—you can deduct only the portion of medical and dental expenses that exceeds 7.5 percent of adjusted gross income. Further, the IRS limits the amount of long-term care premium a taxpayer can include as eligible medical care expenses based on age attained before the close of the tax year.

For 2013, those limitations are:
Age 40 or less: $360
41 to 50: $680
51 to 60: $1,360
61 to 70: $3,640
More than 70 $4,550

To learn more about long-term care insurance, please contact us.

401(k) Basics

Most (85 percent) of employers with ten or more full-time workers find defined contribution (DC) retirement plans, such as 401(k) s, valuable in helping to retain, recruit and motivate employees. And a surprising 72 percent of similarly sized employers that do not offer a DC plan agree.* To find out why, read on.

Advantages for Employees

A 401(k) plan allows employees to contribute to an individual retirement savings account set up on their behalf by the employer. Employees enjoy the following advantages:

- They can make salary deferral contributions to traditional 401(k)s, reducing current taxable income.
- They do not have to include employer contributions in their taxable income until they withdraw the funds. (Subject to certain limitations.)
- They can direct their funds into various investment vehicles, if their plan allows, according to their appetite for risk and other factors.
- Their funds will grow tax-free until they are distributed.
- They can easily see their retirement balances at any time, unlike traditional pensions, which require complicated actuarial calculations.
- They own their accounts; they can take all vested funds with them if they leave your employ.

A 401(k) plan offers the following advantages to employers:

- Employers can use a well-designed plan to help attract and keep talented employees.
- Employee salary deferral contributions reduce employers' payroll tax liability.
- Employers can deduct their administration expenses and any contributions they make to employees' accounts as business expenses.
- Employers limit their liability to a defined contribution, unlike with traditional pension plans.

To set up a 401(k) plan, employers must adopt a written document that serves as the foundation for day-to-day plan operations. If you have hired someone to help with your plan, that person likely will provide the document.

Once you have decided on a 401(k) plan, you will need to choose the type plan that is best for you—a traditional 401(k) plan, a safe harbor 401(k) plan, or SIMPLE 401(k) plan.

Traditional 401(k) plans. A traditional 401(k) plan allows eligible employees to make pre-tax elective deferrals through payroll deductions.

Employers can make contributions on behalf of all participants, make matching contributions based on employees' elective defer-

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rals, or both. In traditional 401(k) plans, you can design your plan so that employer contributions vest over time, according to a schedule. Employees forfeit unvested funds when they leave your employment. (Employee contributions are always 100 percent vested, or owned, by the employee.)

Traditional 401(k) plans cannot discriminate in favor of highly compensated employees. This means average deferred wages and employer matching contributions for highly compensated employees cannot greatly exceed average deferrals and matches for non-highly compensated employees. To ensure that the plan satisfies these requirements, the employer must perform annual tests, known as the Actual Deferral Percentage (ADP) and Actual Contribution Percentage (ACP) tests.

Safe harbor 401(k) plans. A safe harbor 401(k) plan lets employers avoid the nondiscrimination tests that apply to traditional 401(k) plans. It resembles a traditional 401(k) plan, but, among other things, requires employer contributions that are fully vested when made. Employers can make matching contributions limited to employees who defer, or contributions on behalf of all eligible employees, regardless of whether they make elective deferrals.

Employers sponsoring safe harbor 401(k) plans must satisfy certain notice requirements. Each eligible employee for the plan year must receive written notice of his/her rights and obligations under the plan. The notice must describe the safe harbor method in use and how eligible employees make elections, and other pertinent information.

Employers of any size can use a traditional or safe harbor plan; they can also combine these plans with other retirement plans.

SIMPLE 401(k) plans. The SIMPLE 401(k) plan gives small businesses a simple, cost-efficient way to offer retirement benefits to their employees. It exempts plan sponsors from the annual nondiscrimination tests that apply to traditional 401(k) plans. As with a safe harbor 401(k) plan, the employer must make employer contributions that are fully vested.

To be eligible for a SIMPLE 401(k), an employer must have 100 or fewer employees who received at least $5,000 in compensation from the employer for the preceding calendar year and no other employee retirement plan.

Roth Contributions

Employers with a traditional, safe harbor or SIMPLE 401(k) plan can allow employees to make Roth contributions, if plan documents permit. With Roth contributions, employees designate some or all of their contributions as Roth contributions and make them with after-tax dollars. This lets them avoid taxation on these funds when withdrawn after retirement, subject to certain conditions.

IRS code limits the total amount contributed to all 401(k) accounts from both employers and employees, including Roth contributions, for any one year. For 2013, contributions cannot exceed $17,500, plus an additional $5,500 in catch-up contributions for participants age 50 or older by year-end. Limits typically increase every year to reflect cost of living adjustments.

Over time, a 401(k) fund can grow into a tidy nest egg and help you retain valuable employees. For more information on setting up a 401(k) plan, please contact us. ■

**Source: American Benefits Institute, "Attitudes of Employee Benefits Decision Makers Toward Retirement Plan Tax Proposals," December 11, 2012*

Are You Ready for October 1?

Only half of Americans surveyed said they knew enough about the Patient Protection and Affordable Care Act, or ACA, according to a Kaiser Family Foundation survey. The survey also found a surprising 42 percent of respondents thought the Supreme Court had overturned or that Congress had repealed the ACA. (Neither is true.) Despite this lack of knowledge—and the major changes coming—payroll service provider ADP found that only one in five employers planned to increase their benefit communication budget.

If your organization offers health insurance, you will want to let your employees know that:

"Affordability" is relative. The ACA requires employers with 50 or more full-time equivalent employees to provide "affordable" health insurance to all full-time employees. Any employee who meets the ACA's definition of full-time (generally, who works 30 or more hours per week) will qualify for subsidized coverage only if the cost of *single-only* coverage under your plan exceeds 9.5 percent of wages on his/her W-2. It does not apply to family coverage, even if the employee has family coverage.

Group plans often have cost advantages. Group plans, particularly large group plans, can spread risks over larger numbers of employees. This allows them to offer lower premiums, enhanced coverages or both.

Employer-provided health benefits have tax advantages. If employees purchase a health plan through the marketplace instead of accepting employer-sponsored coverage, they may lose the employer contribution (if any). They may also lose significant tax advantages. Employer-paid premiums do not count towards taxable income for federal and state income tax purposes. And employees make contributions toward qualified employer-sponsored health plans with pre-tax dollars. If they buy coverage on the marketplace, they will pay with after-tax dollars.

An experienced and knowledgeable insurance broker can help your employees answer questions about their employer-sponsored coverage during enrollments. For more information, please contact us.

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