IRS Notice Provides Additional Information on Cadillac Tax

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Yesterday the Internal Revenue Service (IRS) released Notice 2015-52 with additional information on the excise tax on high cost employer-sponsored health coverage. The IRS Notice raises a number of issues with respect to implementation of the excise tax and asks for public comments no later than October 1, 2015. While the new guidance still leaves many open issues, it seems that they have heard our requests related to: i) the exclusion of carryover amounts from the Cadillac plan tax determination in subsequent years; and ii) the timing of account based plan accruals. These topics will be addressed in more detail in our conference next week in Austin. In the interim, relevant excerpts are included below:

Treasury and IRS are considering an approach under which contributions to account-based plans would be allocated on a pro-rata basis over the period to which the contribution relates (generally, the plan year), regardless of the timing of the contributions during the period. Treasury and IRS anticipate that this allocation rule would apply to HSAs, Archer MSAs, FSAs, and HRAs that are applicable coverage. For example, if an employer contributes an amount to an HSA for an employee for a plan year, that contribution would be allocated ratably to each calendar month of the plan year, regardless of when the employer actually contributes the amount to the HSA. Similarly, if an employee elects to contribute to an FSA for a plan year, the employee's total contributions would be allocated ratably to each calendar month of the plan year, even though the entire amount contributed for the plan year would be available to reimburse qualified medical expenses on the first day of the plan year. Comments are requested on this approach as well as alternative approaches.

To avoid the double counting associated with taking salary deferral amounts that are carried over from one year to another year into account in determining the cost of coverage in both the year of contribution and the subsequent year, which would be the result under the general rule outlined above, Treasury and IRS are considering providing a safe harbor. Under this safe harbor, the cost of applicable coverage for the plan year would be the amount of an employee's salary reduction without regard to carry-over amounts. Unused amounts that are carried forward would be taken into account when initially funded by salary reduction but would be disregarded when used to reimburse expenses in a later year. For example, if an employee elected to reduce his salary by $1,200 to contribute to an FSA in a given year, the FSA's cost of applicable coverage in that year would be $1,200 even if some or all of the $1,200 was not used to reimburse expenses in that year. Accordingly, if that same employee carried over $500 of unused funds that were used to reimburse expenses in the second year, and elected no new salary reduction for the second year, the FSA's cost of applicable coverage in the second year would be $0.
The possible safe harbor described above would be limited to cases in which non-elective flex credits are not available for use in the FSA. To address situations in which non-elective flex credits are available under a cafeteria plan that includes an FSA, Treasury and IRS are considering a variation on the safe harbor that would allow an FSA with non-elective flex credits to be valued under the safe harbor described in the preceding paragraph in certain situations.

The Notice also discusses options on determining who administers a plan for purposes of being liable for the tax. The options being considered are either the entity performing the day-to-day functions administering the plan or the entity with ultimate responsibility for the plan (presumably the employer). Comments are requested about these approaches.

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About Employers Council on Flexible Compensation

The Employers Council on Flexible Compensation (ECFC) is a non-profit organization dedicated to the maintenance and expansion of private employee benefit programs on a tax-advantaged basis. The organization has two driving missions. The first is to represent and promote flexible compensation programs through effective lobbying. The second is to provide information on flexible compensation programs to member, national opinion leaders and the general public to help create a positive climate for the growth of flexible compensation.

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