Wood LLP Tax Alert

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# Obamacare Cadillac Tax Is No Rolls Royce. New IRS Guidance Makes It A Lemon

Maybe the IRS should be renamed the ACAA, for Affordable Care Act Agency? After all, the Supreme Court upheld Obamacare as a tax law. The ~~health care~~ tax law is complex and has many taxes in it. And the IRS is involved in a big way. The tax filing season this year has already been marred with filing difficulties, including 800,000 incorrect tax statements that were sent. Fortunately, within days the wrong Obamacare form tax filers got relief from the IRS.

But there are plenty of other taxes under the Affordable Care Act. One tax that hasn't yet kicked in is the so-called Cadillac tax. When the law was enacted in 2010, it was understandable that no one worried about a tax that could not apply until 2018. But as it gets closer, well, it's different.

And the IRS has just issued a complex and confusing notice about how this tax would apply and to whom. The IRS showcases just how incredibly complex it is. Even the notice itself is a rambling tour. It flags many issues and raises many potential applications as the IRS sets out approaches to the excise tax.


To its credit, the IRS asks for comments from tax professionals and impacted parties. It is enormously complex and nuanced, and the IRS says there will be another one of these general approach notices before it tries to issue Proposed Treasury Regulations.

Of all the taxes in the ironically named Affordable Care Act, none is more onerous than the Cadillac tax. It is a big tax too, a whopping 40% on top of all other federal taxes. What's more, it is an excise tax, one of the most dreaded kinds of taxes there is. It is a rifle shot tax that is supposed to discourage something very specific.

And it now looks likely to apply to more and more people, and to more and more plans. In that sense, it is a kind of rifle shot that has turned into a shotgun blast. You may not have noticed this tax or even heard of it. One reason is the delayed effective date, not kicking in until 2018. That delayed effective date clearly de-emphasized the provision.

It targets plans that are overly generous employer-provided health care plans. No, that doesn't just mean for executives. In fact, it mostly appears to hit union plans. Unions often negotiate for rich benefits and may be willing to take lower cash wages as a trade-off. Unions that have negotiated for generous health benefits may now wish they hadn't.

The theory of the law is apparently that health insurance should be the great leveler. The Affordable Care Act included the Cadillac tax as a tool to cut health care costs. It puts direct and forceful pressure on employers to offer less-generous health insurance plans than in the past. Starting in 2018, Obamacare imposes a 40% tax on the cost of individual health plans above $10,200 for individuals and $27,500 for family coverage.

These thresholds are indexed to inflation. In evaluating these dreaded thresholds, both employer and worker contributions are included. The tax is decidedly punitive. The tax applies to every dollar above those thresholds. Like a cliff, the dollars are taxed at a 40% rate.

What's more, the tax is not deductible by the employer. The Cadillac tax makes sure that more health insurance dollars are spent across a greater number of people. It was probably a bad idea even before the news broke that a once famous and now nearly infamous adviser had a big hand in it. It seems almost dastardly now, a real bait and switch. The tax is projected to collect $80 billion between 2018 and 2023.

However, many excise tax figures turn out not to be remotely close to correct. Indeed, excise taxes are often enacted to discourage particular behavior. Here, a reasonable response to the Cadillac tax is likely to be cutting of health insurance. Why would employers want to offer generous health insurance that triggers a 40% excise tax that they must pay and that they cannot deduct?

Less generous coverage will presumably be provided. Of course, it is possible that some employers will buck this trend. Perhaps public employers such as cities employing union workers may be among them. In a curious twist, American taxpayers could end up carrying the burden of the tax.

In large part, the result is likely to higher costs for employees, higher deductibles, and other add-ons that will harm employees. Doesn't that go directly contrary to what proponents of the Affordable Care Act–including the President–represented?

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