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Robin Lunge, Director

MEMORANDUM

To: House Committee on Appropriations
House Committee on Education
House Committee on General, Housing and Military Affairs
House Committee on Government Operations
House Committee on Health Care
House Committee on Ways and Means
Senate Committee on Appropriations
Senate Committee on Education
Senate Committee on Economic Development, Housing and General Affairs
Senate Committee on Government Operations
Senate Committee on Health and Welfare
Senate Committee on Finance
Health Reform Oversight Committee

From: Robin Lunge, Director of Health Care Reform
Michael Costa, Deputy Director of Health Care Reform

Date: January 4, 2016

Re: Impact of Federal Budget Agreement on the Public Employees' Benefits Study Submitted Pursuant to Act 54 of 2015 and Act 46 of 2015.

The recently adopted federal budget contained three sections related to IRC 4980I, the Excise Tax on High Cost Employer Sponsored Health Coverage. Specifically, the bill made two significant changes to current law, delaying the tax by two years and allowing the tax to be deducted. Additionally, the bill directed the Comptroller General to conduct a study of the age and gender tax threshold adjustment that may have a significant impact on how the tax is calculated and potential future tax liabilities. This memorandum provides some considerations for stakeholders regarding these provisions. The text of the relevant sections is available on pages 2000-2001 here: http://docs.house.gov/billsthisweek/20151214/CPRT-114-HPRT-RU00-SAHR2029-AMNT1final.pdf

Delayed Implementation

Delayed implementation provides certainty for 2018 and 2019 by removing the first two years of estimated tax liability set forth in the study. Under this change, employers would not begin to accrue tax liability until at least 2020, with the first tax payments likely due in 2021.

It is unclear what strategy Congress will take for 2020 and beyond. Congress may let the tax be implemented as written starting in 2020, patch the tax for a year or more as they did this year, amend the tax in some other way, or repeal the tax. The range of outcomes creates uncertainty regarding whether or how to pursue the tax mitigation strategies identified in the State's report to anticipate the tax or take a wait and see approach. Implementing the tax in 2020 without additional changes would make the first year of the tax more expensive than if it began in 2018 and may require more disruptive changes to employer benefit plans, employee benefits, and budgets.

Deductibility

This change should benefit public employers in Vermont, particularly those purchasing a fully insured product.

Overall, the employer is responsible for calculating the tax and reporting it to both the IRS and the "coverage provider" who is responsible for paying the tax. The taxpayer is always an insurer, employer, or person who administers the plan. The IRS is still considering approaches for determining who is the "person that administers the benefit plan." The study identified this uncertainty regarding whether certain study participants will pay the tax directly or pay the tax through their administrator. This distinction mattered because the tax was not deductible under the original law.

Being non-deductible meant that an insurer or administrator remitting the tax on an employer's behalf would record that tax payment as taxable income and be allowed to charge the employer a gross up amount sufficient to cover the income tax liability incurred by the insurer or administrator. Essentially, employers could pay twice, once for the tax and once for the tax liability of the party remitting the tax. Making the tax payment deductible for insurers/administrators means that fully insured entities will not need to pay twice. Additionally, this reduces the risks associated with being unsure who remits the tax for other study participants.

Age and Gender Adjustment Study

The federal budget directs the Comptroller General to study the benchmark used for the age and gender tax threshold adjustment and deliver its report within the next 18 months. The age and gender adjustment allows employers to increase their tax threshold (and reduce tax owed) if the employee group is older or includes more women on average than the national workforce. Our study identified the calculation of the age and gender adjustment as one of the most important and uncertain issues regarding the tax.

The Vermont study estimated that the age and gender adjustment reduced tax liability for each employer and reduced overall tax liability by millions of dollars starting in 2018. Yet, our actuaries made these calculations based on incomplete IRS guidance and in the absence of final regulations. The new federal study muddies the waters further. The federal study may delay final federal guidance on the adjustment for several years. Additionally, any subsequent change to federal law arising from the federal study may deviate substantially from the current guidance and the Vermont study's actuarial analysis. It is unlikely that we will gain any additional clarity on this issue until at least the publication of the federal study, due not later than eighteen months from now.