

April 15, 2015

The Honorable Orrin Hatch
Chairman
Committee on Finance
United States Senate
Washington, DC 20510

The Honorable Ron Wyden
Ranking Member
Committee on Finance
United States Senate
Washington, DC 20510

Dear Chairman Hatch and Ranking Member Wyden,

WageWorks endorses the efforts of the Senate Finance Committee to engage the public and interested stakeholders to achieve a simpler, fairer, and more focused Tax Code. This goal is both laudable and achievable. WageWorks, a leading provider of tax-preferred benefit services to employers and their employee participants, urges the Committee to use Tax Reform to further examine the practical implications – and potential adverse effects – of limiting the “exclusion” for employer-provided health insurance.¹ Currently, the Excise Tax on High-Cost Employer-Sponsored Health Coverage – enacted under the Patient Protection and Affordable Care Act (“ACA”) – places an indirect limitation on the exclusion. Although the Excise Tax is not effective until January 1, 2018, the prospect of administering the Tax – and more importantly, paying the Tax as it is passed through to the employer and its employees – is already having a material effect on private- and public-sector, unionized and non-unionized employers.

Put simply, the Tax threatens the future of the employer-sponsored health system, which currently provides quality and affordable health coverage to close to 160 million Americans. For example, credible surveys show that a large percentage of employers currently offering employer-provided health coverage will trigger the Excise Tax in 2018, and a significant percentage of employers will trigger the Excise Tax by 2023. The prospect of paying the Excise Tax – as it is passed through to the employer and its employees – is leading many employers to re-evaluate whether they should continue to offer employer-provided health coverage. More importantly, the statute currently requires employers to calculate the amount of the Excise Tax due, and also notify the Internal Revenue Service (“IRS”) and the entities responsible for paying the Tax. This effectively requires the employer to serve as the “collector” of the Excise Tax, along with the means through which the IRS can enforce the Tax. Based on this burdensome requirement, employers are currently asking whether they should simply exit the employer-sponsored health system as an alternative to acting in this capacity.

The Excise Tax on High-Cost Employer-Sponsored Health Coverage

¹ The “exclusion” for employer-provided health insurance generally refers to Section 106 of the Internal Revenue Code (“Code”). Code section 106 provides that “employer” contributions used to pay for health insurance coverage under an “accident and health plan” are not taxable to an employee for income tax purposes. These employer contributions are also not taxable to an employee for FICA tax purposes. [see Code section 3121(a)(2)(B)]. In cases where an employee makes salary reduction contributions to a health Flexible Spending Arrangement (“Health FSA”) and to a Health Savings Account (“HSA”) through a Code section 125 cafeteria plan, these employee contributions are considered “employer” contributions so they may similarly be excluded for income tax purposes (under Code section 106) and FICA tax purposes (under Code section 3121(a)(2)(B)).

1. What Is the Excise Tax and What Type of Health Coverage Is Counted Toward the Tax?

The ACA added section 4980I to the Internal Revenue Code (“Code”), imposing a 40 percent excise tax on employer-sponsored health coverage that exceeds \$10,200 for individuals and \$27,500 for families beginning January 1, 2018. These dollar thresholds will be increased (1) on account of age and gender and (2) for retirees and individuals who work in “high-risk professions” or are employed to repair or install electrical or telecommunications lines.² Importantly, these thresholds are indexed to the Consumer Price Index (“CPI”) plus one percent in 2019, and then beginning in 2020 and for years thereafter, these thresholds will only increase based on changes in CPI.³

For purposes of determining whether the cost of the employer-sponsored coverage exceeds the dollar thresholds described above, the aggregate value of the *entire* package of health care coverage is taken into account.⁴ This means that in addition to the premium costs of an ACA-compliant major medical plan and certain other types of health coverage, employer contributions made to a Health Reimbursement Arrangement (“HRA”) – and *both* employee and employer contributions made to a Health Flexible Spending Arrangement (“Health FSA”) – are counted for purposes of the Tax.⁵ Importantly, employee contributions to a Health Savings Account (“HSA”) made through a Code section 125 cafeteria plan are included in the calculation of the Tax, in addition to employer HSA contributions.⁶

2. How Is the Excise Tax Calculated and Administered?

The Excise Tax is imposed *pro rata* on (1) an insurance company, (2) a plan administrator of a self-insured major medical plan, a Health FSA, and/or an HRA (which may in some cases be the employer), and (3) the employer itself (in cases where the employer directly makes HSA contributions on an employee’s behalf, or an employee makes their own HSA contributions through a Code section 125 cafeteria plan). For purposes of determining the allocable share of the Tax, the employer offering the health coverage is responsible for aggregating the cost of the *entire* package of such coverage for *each* employee.⁷

If this calculation shows that the cost of the coverage exceeds the dollar thresholds described above, the employer must isolate the amount that exceeds the dollar thresholds and calculate the Tax payable by (1) the insurance company, (2) the plan administrator (in the case of a self-insured major medical plan, Health FSA, or HRA), and/or (3) the employer (in the case the employer self-administers its major medical plan, Health FSA, or HRA, or in the case of employer HSA contributions and employee HSA contributions made through a Code section 125 cafeteria plan).⁸ The employer is then required to

² Code section 4980I(b)(3)(C)(iii), (iv).

³ Code section 4980I(b)(3)(C)(v).

⁴ Code section 4980I(d)(1).

⁵ Code section 4980I(d)(1)(A), (d)(2)(B).

⁶ Code section 4980I(d)(2)(C). Employer contributions to an Archer medical savings account (“MSA”) are also counted towards meeting the single and family coverage thresholds.

⁷ Code section 4980I(c)(4)(A)(i).

⁸ See Code section 4980I(c)(3).

notify each of these entities of the amount of the Tax owed.⁹ In addition, the employer must report the amount of the Tax payable by each entity to the IRS.¹⁰

The Excise Tax on High-Cost Employer-Sponsored Health Coverage and Its Impact on Employer Behavior

1. *How Is the Excise Tax Impacting Employers Currently Offering Employer-Provided Health Coverage?*

Leading surveys indicate that 48 percent of employers currently offering health coverage to their workers are projected to exceed the Excise Tax's dollar thresholds in 2018, and 82 percent of employers currently offering health coverage could trigger the Tax by 2023.¹¹ More conservative estimates suggest that more than a third of large employers will trigger the Excise Tax in 2018, and close to 60 percent of these employers will exceed the Excise Tax's dollar thresholds by 2022.¹² A strong argument can be made that Congress did not intend to impact such a significant percentage of employers currently offering health benefits to their employees.

It is important to point out that in 2009, a political decision was made that the Excise Tax should not fall directly on an employee, but rather, the "incidence of tax" should be imposed on (1) the insurance carrier, (2) the administrator of any self-funded benefits, and (3) the employer (in the case of, among other things, employer HSA contributions and employee HSA contributions made through a Code section 125 plan). Virtually every economist – including the Congressional Budget Office ("CBO") and the Joint Committee on Taxation ("JCT") – will explain that excise taxes imposed on a particular entity will ultimately be passed through to the consumer.¹³ In the case of the Excise Tax on High-Cost Employer-Sponsored Health Coverage, the consumer is effectively the employer offering health coverage, along with its employee actually receiving the health insurance coverage. Thus, in reality, the employer and employee will *indirectly* pay the Excise Tax, which a number of members of Congress also made clear during the health care reform debate.

As a result, even in advance of January 1, 2018, public- and private-sector employers – along with unions with collectively bargained health and welfare plans – are being forced to take action to avoid paying the Excise Tax, along with taking steps to shield their employee participants from paying the Tax. This is adversely affecting low- and middle-income workers and forcing employers and unions to shift more cost onto their employees/members. In some cases, employers are considering exiting the employer-based health system altogether. This is a result that Congress never intended.

2. *How Is the Requirement to Calculate and Administer the Excise Tax Impacting the Employer-Sponsored Health System?*

⁹ Code section 4980I(c)(4)(A)(ii).

¹⁰ *Id.*

¹¹ TowersWatson, *2014 Health Care Changes Ahead Survey* (Sept. 2014).

¹² American Health Policy Institute, *The Impact the Health Care Excise Tax on U.S. Employees and Employers* (November 2014); *see also*, Mercer, *National Survey of Employer-Sponsored Health Plans* (November 2014).

¹³ *See* The Congressional Budget Office and Joint Committee on Taxation, *Analysis of Health Insurance Premiums Under the Patient Protection and Affordable Care Act*, November 30, 2009, pages 15-16 at <http://www.cbo.gov/ftpdocs/107xx/doc10781/11-30-Premiums.pdf>.

As discussed, in the case of the Excise Tax, the “incidence of tax” falls on (1) the insurance carrier, (2) the administrator of any self-funded benefits, and (3) the employer in certain cases. To ensure that a tax structured in this manner could be determined and actually paid over to the IRS, a policy decision was made to require the employer – and not the IRS – to (1) calculate the amount of the Tax owed, and then (2) notify the IRS and those entities that are technically required to pay the Tax. This effectively means that the employer will serve as the “Tax Collector,” along with the means through which the IRS can enforce the Tax

Specifically, the employer is required to determine whether the aggregate amount of health coverage exceeds the Excise Tax’s dollar thresholds for *each* employee. In other words, the employer will be required to determine – on an employee-by-employee basis – (1) the different types of health coverage for a particular employee, (2) the aggregate cost of that coverage, and (3) the amount, if any, that exceeds the Excise Tax’s dollar thresholds. The following two examples illustrate this:

- Jane is covered by a self-insured high deductible health plan (“HDHP”) administered by XYZ Third-Party Administrator (“XYZ TPA”). Jane also makes employee contributions to an HSA through a Code section 125 cafeteria plan, and Jane’s employer – ACME, Inc. – makes matching employer HSA contributions. ACME, Inc. is required to aggregate (1) the cost of the HDHP, with (2) Jane’s HSA contributions made through the 125 cafeteria plan, and (3) ACME Inc.’s HSA contributions. If the aggregated cost of the HDHP and the employee and employer HSA contributions exceed the Excise Tax’s dollar thresholds for the year, ACME, Inc. must calculate the amount of Tax due, and then apportion that Tax liability among XYZ TPA and ACME, Inc. itself.
- Judy is covered by a fully-insured PPO option under-written by Insurer Co. Judy also makes employee salary reduction contributions to her Health FSA administered by QRS Third-Party Administrator (“QRS TPA”). And, ACME, Inc. makes employer Health FSA contributions on Judy’s behalf. Here, ACME, Inc. must aggregate (1) the cost of the PPO, with (2) Judy’s salary reduction Health FSA contributions, and (3) ACME, Inc.’s Health FSA contributions. If the aggregated cost exceeds the Excise Tax’s dollar thresholds for the year, ACME, Inc. must calculate the amount of Tax due, and then apportion that Tax liability among Insurer Co. and QRS TPA.

An employer like ACME Inc. must then repeat this aggregation process for *each* of its employees. However, because every employee is unique – with, for example, their own self-only or family major medical plan, and different employee contribution amounts – some employees may have health coverage that exceeds the dollar thresholds, and other employees with health coverage under the dollar thresholds. Requiring an employer to engage in this employee-by-employee examination will be extremely time-consuming. This requirement will also place a significant burden on employers (1) trying to offer quality health coverage and (2) seeking to provide flexibility for employees by allowing them to choose certain types of health coverage that best fits their needs and preferences. Based on this, it is reasonable to ask: Could an employer choose to limit the health coverage it offers to a major medical health plan *only* (i.e., an employer may eliminate offering other types of coverage like Health FSAs or providing an employee the opportunity to contribute to an HSA through a 125 cafeteria plan)? Could this also produce perverse results where an employer makes hiring and/or firing decisions based on the health care needs of a particular employee? It does not appear Congress would have ever intended for these behavioral changes to occur.

Then, to add to the administrative burdens associated with calculating the Excise Tax on an employee-by-employee basis, the statute requires the employer to essentially send a “Tax Bill” to, for example, an insurance carrier and/or the administrator of self-funded benefits, and even the employer

itself in certain cases. The IRS must also be notified of the Tax Bill sent to each of these entities, specifying the amount of the Excise Tax due. These looming burdens associated with calculating and administering the Excise Tax could lead employers to simply exit the employer-sponsored health system as an alternative to attempting to comply in the first place. Again, a result that Congress never intended.

The Excise Tax on High-Cost Employer-Sponsored Health Coverage and Its Impact on Consumer-Driven Health Plans

Both Republicans and Democrats are supportive of Consumer-Driven Health Plans (CDHPs), which generally are HDHPs coupled with an HRA or an HSA. In some cases, using account-based plans like Health FSAs to pay for certain out-of-pocket medical expenses are also offered when adopting a CDHP strategy. Surveys show that more and more employers are choosing to offer CDHPs, due in large part to the belief that by offering these types of arrangements, employees will become increasingly engaged in making health care utilization decisions, which could result in a reduction in health care spending overall.¹⁴ Recent surveys also show that employers intend to expand account-based CDHP offerings as a way to minimize the impact of the Excise Tax (again, this may include Health FSAs in addition to an HRA or an HSA offering, where employees may choose which account-based arrangement is best for them).¹⁵

However, the Excise Tax will have a chilling effect on CDHPs solely based on how employers are required to calculate the Tax. As described above, employer contributions to an HRA and an HSA – along with employee contributions to a Health FSA and employee contributions to an HSA made through a Code section 125 cafeteria plan – are all counted toward the Tax. As also described above, while the Excise Tax is not imposed directly on the employer and its employees, the Excise Tax will be passed through such that the employer and its employees will indirectly pay the Tax. To avoid this result, employers may respond by terminating CDHP options and Health FSAs. Specifically, an employer may choose not to make a Health FSA available to employees, thereby eliminating the requirement to count employee and employer FSA contributions when calculating the Excise Tax. Similarly, employers may opt against allowing their employees to make HSA contributions through a Code section 125 plan, and also discontinue making employer HSA contributions on behalf of employees. In fact, these changes in employer behavior were predicted by CBO in its analyses of the Excise Tax.¹⁶ However, it does not appear that Congress ever intended this adverse impact on CDHPs. Most members of Congress would agree that this result takes the employer-sponsored health system in the wrong direction.

Congressional Action Relating to the Excise Tax on High-Cost Employer-Sponsored Health Coverage

1. Full Repeal of the Excise Tax

WageWorks supports full repeal of the Excise Tax on High-Cost Employer-Sponsored Health Coverage. Completely eliminating the Excise Tax would ensure that the American workforce and the employer-sponsored health system are shielded from irreparable harm. We recognize, however, that doing so would cost the federal government approximately \$87 billion dollars over 10 years and would eliminate a significant offset for the ACA's coverage expansion. WageWorks remains committed to

¹⁴ See, e.g., Mercer, *National Survey of Employer-Sponsored Health Plans* (November 2014).

¹⁵ National Business Group on Health, *Large Employers' 2015 Health Plan Design Survey* (August 2014).

¹⁶ Jenny Gold, 'Cadillac' Insurance Plans Explained, KAISER HEALTH NEWS, Jan. 15, 2010, available at <http://kaiserhealthnews.org/news/cadillac-health-explainer-npr/>.

finding a viable solution, and we invite the Committee to consider WageWorks as a resource and a partner on this very important issue.

2. Alternatives to Full Repeal of the Excise Tax

Short of full repeal, there are other ways Congress could minimize the burden on employers and employees, such as adjusting the dollar thresholds and annual inflation adjustment from CPI to annual increases in premiums or, for example, medical inflation. In addition, the Excise Tax could be means tested to make the Tax less regressive. Like other tax-preferred benefits – such as retirement savings (e.g., Roth IRAs) – the Excise Tax could be means tested such that health coverage offered to highly compensated individuals that exceeds the Excise Tax’s dollar thresholds for the year triggers the Tax.

However, this does not resolve the administrative burdens associated with the Excise Tax’s indirect limitation on the exclusion. There are thoughtful proposals that would impose a direct cap on the exclusion at certain income levels, or the exclusion may phase out beyond a certain tax rate. But, tying any limitation on the exclusion to an aggregate value of employer-provided health coverage – which in most cases neither the employer nor the employee can truly control¹⁷ – subjects millions of working Americans to a Tax that disproportionately affects low- and middle-income employees. One alternative is tying a limitation on the exclusion to the “actuarial value” (“AV”) of a major medical plan only – or an aggregate AV that includes certain types of health coverage – but is thoughtful in its approach, and does not adversely impact CDHPs (e.g., the alternative excludes employee contributions to a Health FSA and employee contributions to an HSA through a Code section 125 plan).

3. Provide for an Explicit Exception for Employee Health FSA Contributions and Employee HSA Contributions Made Through a Code Section 125 Plan From the Excise Tax

The IRS has long-held the position that employee Health FSA contributions and employee HSA contributions made through a Code section 125 cafeteria plan are “employer” contributions for tax purposes. This legal fiction was created so that these employee contributions may be shielded from income and FICA taxes just like employer contributions for premiums for a major medical plan are not taxed. However, employees electing to put their hard-earned dollars into a designated account to pay for medical expenses should not be treated the same as premiums for a major medical plan. The Excise Tax, however, adheres to the legal fiction created by the IRS, and the Tax sweeps these employee contributions into its calculation. This counterintuitive result can be addressed by removing from the calculation of the Excise Tax employee Health FSA contributions and employee HSA contributions made through a Code section 125 cafeteria plan. Developing such an exception will preserve the growing adoption of CDHPs, which have demonstrated their potential to help “bend the cost curve downward.” This is a goal that shares bi-partisan support.

Immediate Action on the Excise Tax on High-Cost Employer-Sponsored Health Coverage Is Needed

To protect working Americans from losing employer-provided health coverage, having reduced coverage that leaves them vulnerable, and fewer CDHP options, Congress would need to act now. Businesses plan two to three years in advance to structure employee benefits and plan offerings.

¹⁷ For example, employees have the ability to make salary reduction contributions to a Health FSA that may range from as low as \$100 dollars to \$2,500 for the year. In the case of HSA contributions, the employee may similarly choose to make a \$100 contribution or a contribution up to the HSA maximum contribution limit for the year. For 2015, the HSA contribution limit for a self-only plan is \$3,350 and a family plan is \$6,650. These amount are indexed to CPI annually.

Collectively bargained benefits are also negotiated far in advance and are set in place for years at a time. If Congress were to wait until 2017 to repeal or modify the Excise Tax, most employers will have already done whatever they could to minimize their Tax liability, including eliminating Health FSAs and discontinuing employer HSA contributions, along with an employee's ability to make HSA contributions through a Code section 125 cafeteria plan.

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On behalf of WageWorks, the thousands of employers we serve in all 50 states, and millions of employees they cover, we thank you for your consideration of this important issue and for your leadership in engaging the public thoughtfully on an overhaul to our Tax Code. To that end, we share the optimism of many in the business community that your Committee's process will lead to changes in the Excise Tax that do not create an administrative burden for employers or threaten the viability of the employer-sponsored health system.

Sincerely,

A handwritten signature in black ink, appearing to read 'Joe Jackson', with a long horizontal flourish extending to the right.

Joe Jackson
Chief Executive Officer