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Spooky Things Ahead for Employee Benefits During Tax Reform?

After much toil and trouble, Republican lawmakers will be revealing their much anticipated tax reform proposal next week. The message we received from members of Congress and their staff while on Capitol Hill this week was clear: ***Significant changes to the tax treatment of employer-sponsored benefits – both health and retirement – are on the table. Boo!***

Call to Action: If you don't want employees and employers taxed on their benefits, contact Congress today. Click to [send an email](#) to the office of Rep. Kevin Brady (R-TX), Chairman of the House Ways and Means Committee, which is drafting the tax reform legislation. You can also email your members of Congress, who can be found here: [House of Representatives](#) and [Senate](#).

The challenge for those in the process of finalizing the policy largely boils down to finding enough revenue to offset the significant cuts being considered. The two largest caldrons of money that currently go untaxed are employer-sponsored health and retirement benefits, which is why lawmakers are considering new and expanded taxation of these benefits.

For over 70 years employees and retirees have been able to exclude from taxable income the entire amount their employer pays toward the cost of their health coverage. If the employer sponsors a cafeteria plan, then employees are also able to pay their portion of the premium tax-free. Now some in Congress are discussing the addition of a tax on employees and retirees for some or all of the value of their employer-sponsored health coverage. Employers also avoid paying payroll taxes on the excluded contributions. Eliminating or capping the tax exclusion would result in a tax increase on employees, retirees and employers.

Originally we expected Congress would only make changes to the exclusion if they simultaneously repealed the Cadillac tax – the 40 percent excise tax owed by employers if the value of their health coverage offerings exceeds certain thresholds. Creative minds on Capitol Hill have apparently been considering other options that would keep the Cadillac tax while also modifying the exclusion, though possibly only for higher wage earners.

Lockton comment: The impact to employers of a cap on the exclusion and the Cadillac Tax (separately or spookier, together) is more insidious than a greater tax burden. To avoid taxation employers may need to reduce benefits or shift more costs

to employees, making the plan less attractive. The less attractive the employer plan, the more likely healthier employees will leave the plan, which will skew the plan's risk pool, ultimately driving up plan costs.

Republican Lawmakers Hope to Move Quickly on Tax Reform

The tentative schedule for tax reform begins with a bill being introduced in the House next week. GOP leadership is hopeful for final passage in the House by Thanksgiving. That would give the Senate enough time to pass a bill by mid-December, so the new tax rules could go into effect Jan. 1, 2018.

Lockton comment: The timeline is aggressive and may be more aspirational than practical considering the significant policy ramifications and other legislative agenda items. Still, the urgency surrounding the soon-to-be-released bill will likely limit the number of changes that can be made before a final vote. This makes it that much more important for those opposing taxation of employer-sponsored benefits to [act now](#).

A Treat for Employers in the Form of ACA Employer Mandate Relief?

The news this week wasn't all scary for employers, as a proposal from two highly influential GOP committee chairmen aims to waive penalties under the Affordable Care Act's (ACA) employer mandate for 2015 through 2017 – the mandate would again apply beginning in 2018. The proposal is an alternative to the bipartisan bill we described in our prior [Update](#). That bipartisan proposal intends to continue funding for cost sharing reduction (CSR) subsidies in exchange for providing states additional flexibility to waive some ACA market reform requirements.

Conservatives, and eventually President Donald Trump, argued Republicans weren't getting enough in exchange for funding the CSR payments under the original bipartisan outline, which led to the inclusion of the limited employer mandated waiver in the newest proposal. This more conservative measure makes passage through the House more likely; however, passage through the Senate will require bipartisan support, and Senate Democrats have not offered their support.

Lockton comment: The most likely avenue for any CSR-funding bill is inclusion in a broader catch-all bill expected late in the year. It's far from certain that the employer mandate waiver will become law. The best practice for employers until legislation actually passes is to assume the employer mandate will remain in effect, both retroactively and prospectively, which means employers should continue to prepare to report in early 2018 on employer mandate compliance for 2017.

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