Labor and Employment Alert: Form 1095 Deadlines Extended and Other December Developments Impacting Health Benefits

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In a welcome development, the IRS announced on December 28, 2015 (IRS Notice 2016-04) the following extensions of Form 1095-C and Form 1095-B deadlines: **Original Deadline New Extended Deadline** Distribution to employees February 1, 2016 March 31, 2016 (2-month extension) Electronic filing with IRS March 31, 2016 June 30, 2016 (3-month extension) Paper filing with IRS* February 29, 2016 May 31, 2016 (3-month extension)

** Paper filing is only permitted if an entity is filing fewer than 250 Forms 1095-C or 1095-B.*

Combining payroll and human resources data to generate status information in the format required by the IRS has been a significant challenge for employers. As the original deadlines approached, many employers were considering applying for extensions. (Among other problems, some of the software programs for preparing the forms have not been populating correctly.) Fortunately, application is no longer necessary: the extended deadlines are automatically available to all filers.

Other December Developments Impacting Health Benefits

Two-year delay of the Cadillac Tax

The Consolidated Appropriations Act, 2016 (signed December 18, 2015) postpones the application of the Cadillac tax from 2018 to 2020. The Cadillac tax, as originally adopted as part of the Affordable Care Act, was a 40% non-deductible excise tax on high cost group health plans. It was intended to raise revenue and reduce the growth of health care expenditures. The expectation was that employers would scale back non-taxable health coverage to avoid the Cadillac tax and (at least in some cases) increase taxable wages. While economists applaud the concept, unions and much of the business community are united in opposition.

Many hope that the two-year delay is just the first step to eventual repeal. But, in case the Cadillac tax is not repealed, the Consolidated Appropriations Act includes a helpful modification: the Consolidated Appropriations Act changes the Cadillac tax from non-deductible tax to deductible tax. The net expenditure for a deductible tax is of course less than for a non-deductible tax. Plus, if an entity other than the employer (such as an insurer or third-party administrator) is responsible for paying the tax and that entity seeks reimbursement from the employer, the amount of the reimbursement won't be impacted by the entity's marginal tax rate, an important simplification.

Pay or play penalties indexed for 2015 and 2016

IRS Notice 2015-87,Q&A-13 (December 28, 2015) announced indexing of the employer pay or play penalties.
2015 2016 $2,000 IRC §4980H(a) $2,080/year $2,160/year "no offer penalty" $173/month $180/month $3,000 IRC §4980H(b) $3,120/year $3,240/year "unaffordable/inadequate coverage" penalty $260/month $270/month

Pay or play 9.5% affordability percentage indexed for 2015 and 2016

To determine whether the health coverage you offer is affordable, you calculate the following fraction: Numerator: Lowest employee contribution for single health coverage with minimum value Denominator:

One of three proxies for household income:

1. The employee's hourly rate of pay times 1,560 hours (or annual salary);
2. The federal poverty level for a single person (note that you are supposed to use the 2014 amount – $11,670 – for 2015 calculations); or
3. Box 1 of Form W-2.

IRS regulations provide that a result that does not exceed 9.5% is deemed to be "affordable" for purposes of the IRS §4980H(b) unaffordable/inadequate coverage penalty. However, IRS Notice 2015-87, Q&A-12 announced that employers may use 9.56% for plan years beginning in 2015 and 9.66% for plan years beginning in 2016.

Disability benefits = hours of service while employed

IRS Notice 2015-87, Q&A-14 reminds employers that an employee must be credited with hours for periods during which an employee is both: (a) employed; and (b) receiving short-term or long-term disability benefits. This includes periods during which an employee receives insured disability benefits unless the employee paid 100% of the premium for the insurance on an after-tax basis. Of course, no hours are credited for periods after termination of employment regardless of whether the employee continues to receive disability benefits.

In contrast to the treatment of periods during which an employee receives disability benefits, an employee need not be credited with hours for period during which he or she receives workers' compensation income replacement benefits.

Opt-out payments impact the affordability of coverage (but not yet)

An opt-out payment is an amount that an employer pays an employee if and only if the employee waives the employer's medical plan. For example, assume an employee would need to make a salary reduction contribution of $200 per month to enroll in the employer's medical plan and the employer would pay the employee $100 per month if the employee waives the medical plan. In this example (included in IRS Notice 2015-87, Q&A-9), the employee contribution is $300 per month consisting of the $200 salary reduction contribution plus the $100 the employee would give up if he or she enrolled in the employer's medical coverage.

The IRS intends to issue regulations on this point. In the meantime (prior to the issuance of final regulations), an employer that had an opt-out arrangement in effect on December 16, 2015 is not required to include the opt-out payment in its affordability calculations for purpose of the IRC §4980H(b) unaffordable/inadequate coverage penalty.

Despite the temporary exclusion from the employer's affordability calculations, the IRS will include the opt-out payments in determining an employee's eligibility for a subsidy to purchase health insurance on an exchange. The IRS "encourages" (but does not require) employers to provide information to employees on the treatment of opt-out payments for purposes of employees' eligibility for subsidies.

Employers subject to the Service Contract Act catch an overdue break

Under the Service Contract Act and the Davis Bacon Act, certain government contractors are required to provide employees with a combination of wages and benefits that meet certain specified levels. If an employer offers medical benefits and an employee declines to enroll, the employer is then required to pay additional wages so that the employee receives the specified level of compensation. Normally, the difference between the wages an employee would receive while enrolled in employer's health coverage and the wages the employee would receive while not enrolled in the employer medical coverage would be treated as an employee contribution. However, IRS Notice 2015-87, Q&A-10 provides that for at least 2015 and 2016, the employer need not include the difference in its affordability calculations for purpose of the IRC §4980H(b) unaffordable/inadequate coverage penalty.

Despite the temporary exclusion from the employer's affordability calculations, the IRS will include the difference in wages in determining an employee's eligibility for a subsidy to purchase health insurance on an exchange. The IRS "encourages" (but does not require) employers to provide information to employees on the treatment of the difference for purposes of employees' eligibility for subsidies. The IRS suggests either: (a) reporting the higher unaffordable cost on Form 1095-C and claiming the transition relief during the penalty assessment process; or (b) reporting the lower affordable cost on Form 1095-C but sending employees a supplemental communication that explains the "accurate information about their required contribution."

Because this exclusion is temporary, and the "encouraged" employee communication is so unfriendly, employers who have already bargained to eliminate the ability to take cash in lieu of the medical benefits may want to hold firm to that position.

More rules for HRAs

Reimbursement of family members' medical expenses from an HRA

A health reimbursement arrangement (HRA) is an account-based arrangement whereby an employer reimburses medical expenses up to a specified dollar amount. In previous guidance, the IRS has made it abundantly clear that you cannot offer an HRA for an employee who is not enrolled in your medical plan or a medical plan sponsored by a family member's employer. In IRS Notice 2015-87, Q&A-4, the IRS takes this one step further by addressing the reimbursement of family members' expenses from an employee's HRA. Effective for plan years starting on or after January 1, 2016 (or in some cases, January 1, 2017): an HRA cannot reimburse medical expenses incurred by an employee's family member unless that family member is enrolled in your medical plan (or a medical plan sponsored by family member's employer). For example, if an employee enrolls in employee-only medical coverage, you should not permit the employee to use his or her HRA to reimburse medical expenses incurred by the employee's spouse or children (unless you have proof that the spouse and children are enrolled in a medical plan offered by the spouse's employer). This restriction should be added to your HRA plan document.

Reporting an HRA on Form 1095-C

An employer may offer a limited scope HRA, with reimbursements limited to dental and vision expenses. A limited scope HRA is not classified as minimum essential coverage (MEC) and need not be reported on Form 1095-C.

An HRA that reimburses other types of health care expenses (i.e., an HRA that is not limited to reimbursing dental and vision expenses) is classified as MEC. Individuals whose medical expenses are reimbursable from an HRA that is classified as MEC are supposed to be reported as coverage in Part III of Form 1095-C. The only exception is that you need not report individuals who are simultaneously enrolled in your medical plan (or, in the case of a retiree HRA, Medicare). The reason the IRS excuses reporting of an HRA in the months that an individual is simultaneously enrolled in your medical plan (or, in the case of a retiree HRA, Medicare) is that reports of months of access to the HRA would simply duplicate reports of months of enrollment in the medical plan (or Medicare).

Don't confuse HRAs with other account-based arrangements that may be used for medical expenses. Properly structured health flexible spending accounts (FSAs) and health savings accounts (HSAs) are not MEC and are not reportable on Form 1095-C.