IVINS, PHILLIPS & BARKER
CHARTERED

Affordable Care Act – Critical Issues for Tax Departments

Tax Executives Institute
Cincinnati-Columbus Chapter
February 9-10, 2015

Jonathan Zimmerman
(202) 662-3464
JZimmerman@ipbtax.com

Spencer Walters
(202) 662-3459
SWalters@ipbtax.com

Agenda

- Why does the Tax Department care about the ACA?
- Current state of the ACA
  - Overview
  - Enforcement delays and transition relief
- Employer "pay or play" mandate
  - Excise tax guidance
  - Information reporting guidance
- Other taxes, fees, and considerations
- Outlook

Why Does the Tax Department Care?

- The Affordable Care Act (ACA) a health care law, but it's also a tax law
- What tax departments should know:
  1. The core health care coverage provisions are all tax provisions.
  2. The company could become subject to an unexpected, nondeductible excise tax if implementation is not done properly.
  3. Additional taxes and fees apply and some are deductible, others not.
  4. New significant information reporting requirements apply.
  5. How to prepare for an IRS excise tax assessment.

Core Requirements

- The ACA aims to expand health coverage through a series of provisions that generally took effect on January 1, 2014:
  - **Individual mandate:** Mandates all Americans, with some exceptions, to maintain a minimum level of health coverage or face a tax.
  - **Insurance Exchanges**: Creates health insurance Exchanges and provides Premium Tax Credits (PTCs) to assist eligible individuals with the purchase of coverage.
  - **Medicaid expansion:** Allows states to expand Medicaid up to 138% of federal poverty level.
  - **Employer mandate:** Mandates employers with 50 or more full-time equivalents to offer coverage to full-time employees and their dependents or pay taxes if an employee obtains Exchange coverage and a PTC. **Now Effective in 2015**

Phase-in of Employer Requirements

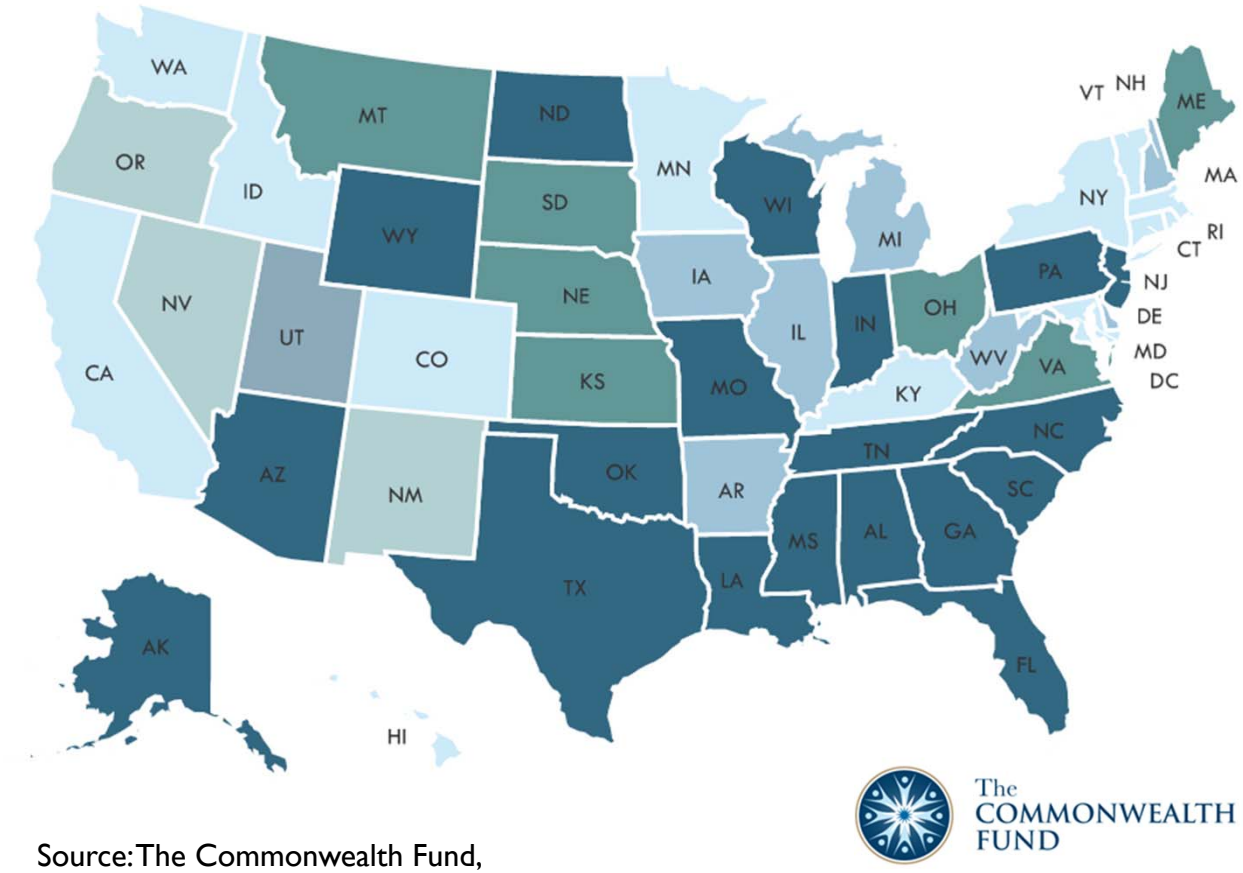
- Employer mandate
  - Notice 2013-45 provides transition relief that delays the employer mandate excise tax and information reporting requirements for one year.
  - Large employers will not face excise taxes under the ACA's employer mandate for 2014; employer excise taxes will not be assessed until 2016, for violations occurring in 2015.
  - Transition relief makes it easier to avoid excise taxes for 2015.
- Information reporting to employees and the IRS
  - Reporting of covered lives by insurers and self-insured employers not required for 2014 coverage; earliest filing due for 2015 coverage to be filed in 2016 (IRC section 6055)
  - Reporting by large employers of coverage offered to full-time employees not required for 2014 coverage; earliest filing for 2015 coverage due to IRS in 2016 (IRC section 6056)

INDIVIDUALS, EMPLOYEES AND EMPLOYERS

Individual Mandate

- Beginning in 2014, individuals must pay a penalty for each month in which they do not have minimum essential coverage (MEC).
  - MEC includes employer-sponsored group health plans, exchange coverage, government-sponsored plans, etc.
  - Penalty is the greater of a flat dollar amount or a percentage of income above filing threshold, up to penalty cap.
  - Annual per person flat dollar amount is $95 for 2014, $325 for 2015, and $695 thereafter.
  - Percentage is 1% for 2014, 2% for 2015, and 2.5% thereafter.
- Exemptions for affordability, hardship, short coverage gaps.
- Individuals report and pay the penalty.

State Exchanges: Current Status

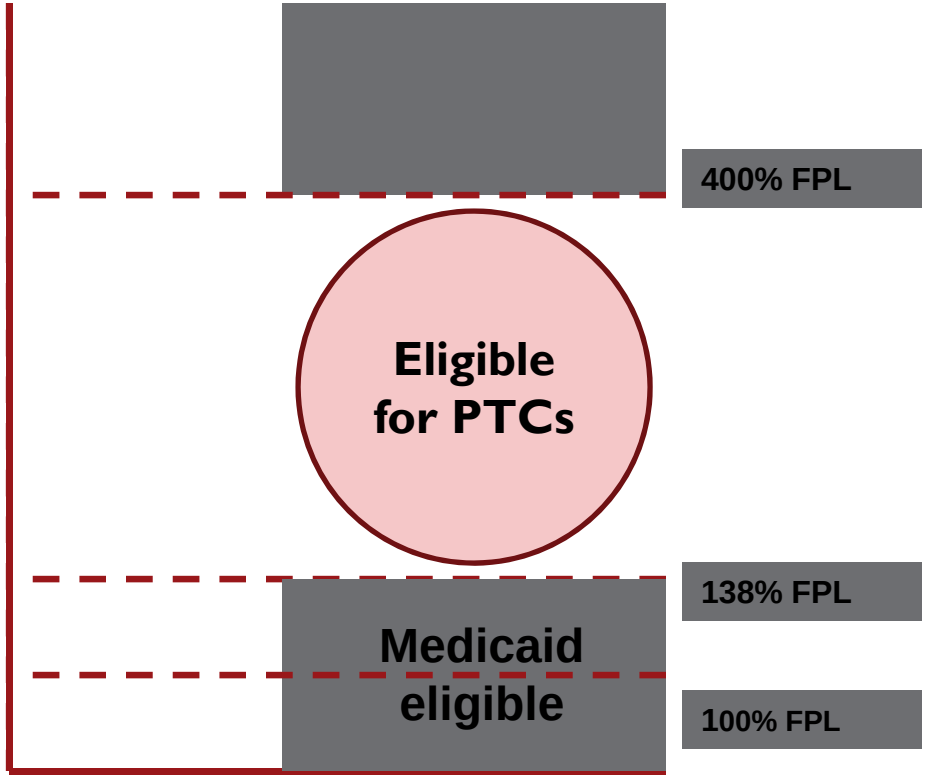


Source: The Commonwealth Fund, www.commonwealthfund.org/interactives-and-data/maps-and-data/state-exchange-map

Premium Tax Credits Available to Individuals

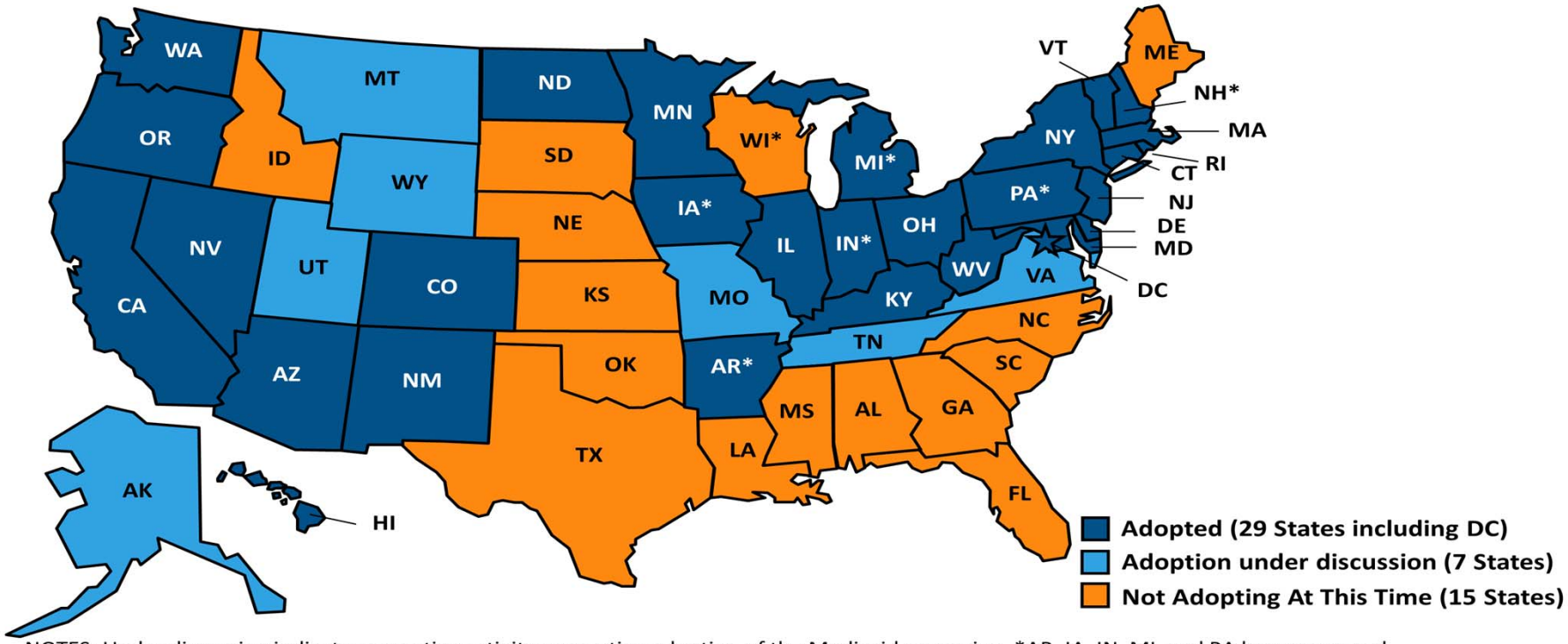
- Section 36B: Eligible individuals entitled to a premium tax credit to purchase health care coverage on an Exchange
  - Taxpayer pays no more than the "applicable percentage" of household income as a premium; tax credit equals remaining premium based on second lowest cost "silver" plan on the Exchange (paid by Treasury directly to the insurer)
- Who is eligible?
  - Household incomes must be between 100% and 400% of FPL
  - Not eligible for other coverage
    - Medicaid, Medicare, or other governmental coverage
    - Offer of affordable employer coverage that provides minimum value

Premium Tax Credits



2014 Federal Poverty Level (Dictates PTC eligibility for 2015)			
Family or Household	100%	138%	400%
1	$11,670	$16,104	$46,680
2	15,730	21,707	62,920
3	19,790	27,310	79,160
4	23,850	32,913	95,400
5	27,910	38,515	111,640
6	31,970	44,118	127,880
7	36,030	49,721	144,120
8	40,090	55,324	160,360

Medicaid Expansion: Current Status



NOTES: Under discussion indicates executive activity supporting adoption of the Medicaid expansion. *AR, IA, IN, MI, and PA have approved Section 1115 waivers. Coverage under the PA waiver went into effect on January 1, 2015, but the newly-elected governor may opt for a state plan amendment. Coverage under the IN waiver is set to begin February 1, 2015. NH has submitted a waiver to continue their expansion via premium assistance. WI covers adults up to 100% FPL in Medicaid, but did not adopt the ACA expansion.

SOURCE: "Status of State Action on the Medicaid Expansion Decision," KFF State Health Facts, updated January 27, 2015.
http://kff.org/health-reform/state-indicator/state-activity-around-expanding-medicaid-under-the-affordable-care-act/

THE HENRY J. KAISER FAMILY FOUNDATION

Premium Tax Credit: Employer Coverage

- To be eligible for a premium tax credit, an individual may not have been offered affordable, minimum value, minimum essential coverage by an employer
- Affordable: Employee portion of the premium or contribution for employee-only coverage under the lowest cost plan cannot exceed 9.5% of household income
- Minimum value: A plan fails to provide minimum value if plan's share of the total allowed costs of benefits provided under the plan is less than 60 percent of such costs (on an actuarial basis)
- Eligibility for premium tax credit is relevant to employer penalties

EMPLOYER MANDATE EXCISE TAX

Section 4980H: General Rule

- "Large employers" (employer with ≥50 full-time equivalent employees within the employer's controlled group) may be subject to an excise tax if at least one full-time employee whose household income is between 100% and 400% of the federal poverty level receives a premium tax credit for exchange coverage and an employer either:

Fails to offer coverage to full-time employees and their dependents

OR

Offers coverage to full-time employees that does not meet the law's affordability or minimum value standards

Section 4980H: Amount of Tax

Tax for no coverage Section 4980H(a)

- A large employer member that does not offer coverage to a specified percentage of its full-time employees and their dependents may face a annual tax (calculated monthly) of:
  - $2,000 x the total number of full-time employees if at least one full-time employee (FTE) is receiving a premium tax credit

Employers who do not offer coverage may subtract the first 30 workers (80 workers for 2015) when calculating their liability for taxes under IRC §4980H(a).

Tax for unaffordable coverage Section 4980H(b)

- A large employer member that offers coverage to its full-time employees and their dependents, but the coverage is unaffordable to certain full-time employees or does not provide minimum value may face an annual tax (calculated monthly) of:
  - $3,000 x the number of FTEs receiving a premium tax credit

Taxes under IRC §4980H(b) are capped at an amount not to exceed an employer's potential tax under IRC §4980H(a).

Section 4980H: Key Facts

- Excise taxes are pro-rated and calculated separately for each month; inflation-adjusted after 2014.
- Excise tax payments are not deductible by the employer.
- Excise taxes are calculated separately for each controlled group member, and CG members are not liable for taxes incurred by other CG members.
- Excise tax under section 4980H(a) applies if the CG member fails to offer minimum value coverage to at least 95% of full-time employees and their dependents (70% for 2015).
- Raises the stakes for worker classification – failure to treat workers as employees could trigger the subsection (b) penalty, or worse, trigger the subsection (a) penalty for failing to satisfy the 95% (70%) safe harbor.
  - Where workers are misclassified, coverage offered by a staffing agency is treated as if it were offered by the employer, if certain requirements are satisfied.

Section 4980H: Applicable Large Employer

- An "applicable large employer" is an employer with at least 50 full-time employees (FTEs) or FTE-equivalents during the preceding year.
  - A FTE works at least 30 hours per week or 130 hours per month.
  - Part-time employees are converted to full-time equivalents.
- Status is determined by dividing the number of FTEs and equivalents for each month by 12.
- All controlled group members are aggregated.
- Transition relief in 2015 for employers with 50-100 FTEs.
- Excise tax is not payable with respect to part-time employees, or first 30 full-time employees (80 for 2015).

Section 4980H: Full-Time Employees

- Employers will need to track hours of service to determine the number of FTEs for each month.
  - Part-time employees are excluded and cannot trigger excise taxes.
  - Hours of service generally include all hours for which the employee is paid, regardless of whether work is performed (vacation, holiday, LOA, etc.).
  - For non-hourly employees, employers may use daily or weekly equivalencies.
  - Hours worked outside the U.S. generally are excluded, regardless of residency/citizenship status.
- Employers may use look-back/stability period safe harbors to determine the number of FTEs.
  - There can be an administrative period in between the look-back and stability periods.
  - Safe harbors do not change the 90-day waiting period rule for offering coverage to new hires, except for seasonal, variable hour, and high turnover employees.
  - 2015 status is determined based on lookback periods in 2014.

Section 4980H: Minimum Value

- Plan must cover at least 60% of total costs based on a standard population.
- IRS/HHS have created a minimum value calculator.
  - Based only on in-network utilization.
  - Design-based safe harbors will be deemed to comply. Each safe harbor will consist of an array of cost-sharing levels (deductibles, co-pays, etc.) and assume coverage for certain services.
- Value also may be determined by an actuary.
- Employer HSA contributions are taken into account.
- Employer HRA contributions are taken into account only if the HRA cannot be used to pay premiums. HRAs that can be used for premium payments count only towards affordability.
- Wellness incentives are disregarded, except for tobacco incentives.

Section 4980H: Affordable Coverage

- Coverage is affordable if the employee's share of premiums for the lowest-cost self-only coverage does not exceed 9.5% of the employee's household income (9.56% for 2015).
- Three safe harbors:
  - Box 1 wages on Form W-2
  - Rate of pay at the beginning of the year
  - Federal poverty level (employee premium does not exceed 9.5% of the FPL)
- Employer HSA contributions are disregarded because they cannot be used to pay premiums.
- Employer HRA contributions are taken into account only if the HRA can be used to pay premiums.
- Wellness incentives are disregarded, except for tobacco incentives.

Section 4980H: Assessment Procedures

- An exchange will notify the employer when an employee is eligible for subsidized exchange coverage.
  - The exchange cannot assess the tax, but the employer may appeal the exchange's determination.
- The IRS will notify employers that they owe a penalty.
  - The IRS will provide this notification after employees have filed their tax returns, and the employer has filed its information returns.
  - The initial taxes for 2015 will not be payable until 2016.
- Employers may respond to the initial IRS notice before the IRS sends a formal notice and demand for payment.
- Penalty payments will not be part of the employer's tax return.

INFORMATION REPORTING

Overview: Employee Communication, Exchanges, Information Reporting, and IRS Tax Assessment

Step 1

- Employer under Fair Labor Standards Act (FLSA) provides employees (including part-time employees) with information about employer coverage and availability of Exchange coverage, within 14 days of hire

Step 2

- Employee provides Exchange with information to determine eligibility for the premium tax credit
- Individual application includes information about employer coverage form

Step 3

- Exchange makes preliminary eligibility determination regarding availability of advanced premium tax credit
- Exchanges may contact employers to verify certain information

Step 4

- Exchange notifies employer that employee may receive a premium tax credit
- Employer may appeal Exchange's determination of employee's eligibility within 90 days

Step 5

- Providers (incl. self-insured plans) report coverage (for individual mandate)
- Employer reports offers of coverage (for employer mandate)
- Employee files personal return

Step 6

- Employee's receipt of premium tax credit subject to reconciliation
- Assessment of employer tax penalties, employer appeals process to IRS

Summary of Employer Reporting Provisions

Due January 31 each year

FORM W-2

§ 6051

- **Purpose:** Provide employees with information on cost of employer-provided coverage
- **Reporting by:** Employers filing 250 Forms W-2 or more
- **Information reported:** Aggregate cost of employer-provided group health plan for each covered employee

Starting 2016, due each January 31 to employee & March 31 to IRS

FORMS 1094-B & C, 1095-B & C

§ 6055

- **Purpose:** Provide individuals and IRS with information to administer individual mandate
- **Reporting by:** Insurance providers, government agencies, multiemployer plans or employers that sponsor self-insured plans
- **Information reported:**
  - Employer- and employee-specific data
  - Months during which individual is covered

§ 6056

- **Purpose:** Provide IRS with information to administer employer mandate and IRS and individuals information to administer premium tax credit
- **Reporting by:** Large employers subject to ACA
- **Information reported:**
  - Employer identifying info; info for all full- time employees
  - Plan data e.g., employee cost, month-by-month

Reporting Requirements: Key Facts

- New reporting required in addition to W-2 reporting of health coverage.
  - Same filing schedule as W-2: To employees by January 31, and to the IRS by March 31 (February 28 if not filed electronically).
- Requirements apply separately to each CG member.
  - Although third party (e.g. the parent) may file the return, liability for failing to file applies to employer, and separate filing must be made for each.
- Failure to file may trigger penalties under Code sections 6721 and 6722.
  - Generally, up to $100 per return, to $1.5 million annual maximum for each violation.
  - May be waived if due to reasonable cause and not willful neglect.
  - Good faith efforts standard for 2016.
- First mandatory filing due in early 2016, for the 2015 calendar year.
  - "Strongly encouraged" for 2014, but there is no penalty for declining to do so (and there are still only draft IRS forms).

Section 6055

- Who is responsible to report
  - Insurers (or the Exchange, on behalf of qualified health plans)
  - Employers sponsoring self-insured plans, including multiemployer plans
  - Governmental entity sponsor of a self-insured plan
- Third party may file on behalf of employer, but employer remains responsible
- Information to be reported – on Form 1095-B (transmitted by Form 1094-B)
  - Name and address and TIN:
    - Primary insured
    - Each individual enrolled in minimum essential coverage
    - Months during which the individual is treated as having minimum essential coverage
    - Insured's SSN/date of birth
  - Single filing to primary insured and dependents
- Filing similar to Form W-2; Employee statement and employer transmittal form

Section 6056: General Method

- In addition to employer identification and health care plan information, large employers must report the following information about their full-time employees:
  - The number of full-time employees for each month during the calendar year
  - Months during the calendar year for which coverage under the plan was available
  - The employee's share of the lowest-cost monthly premium for self-only coverage providing minimum value offered by the employer by calendar month
  - The name, address, and TIN of each full-time employee during the calendar year and the months, if any, during which the employee was covered under an eligible employer plan
- Additional information reported by indicator codes includes:
  - Whether the minimum value standard was met and to whom coverage was offered
  - Reasons why coverage was not offered to an employee (e.g., employee is in a waiting period, employee was not a full-time employee)
  - Whether coverage was offered to non-full-time employees
  - Whether the employer uses one of the affordability safe harbors
  - Contributions to a multiemployer plan

Section 6056: "Simplified" Alternatives

Certification/ Qualifying Offer Method	98% Offer Method	Transition Relief
• For employees that received qualifying offer for all months in which FT • May provide certification to employee instead of 1095-C but only for employees with qualifying offer in all 12 months	• If employer can certify it offered minimum value coverage to at least 98% of employees for whom it is filing 1095-C (even if some of those are not FT) • Need not identify total number of FT employees in a month or whether an employee was FT in particular month	• 2015 Qualifying Offer Transition Relief • 50-99 Transition Relief

6055 & 6056 Reporting: Other Key Issues

- Only draft forms and instructions have been released
- Reporting for a group of related entities
- Providing a single Form 1095-C for an employee
- Correcting mistaken filings

ADDITIONAL TAXES, FEES AND CONSIDERATIONS

Section 4980I: Cadillac Plan Excise Tax

- Code section 4980I imposes a non-deductible, 40% excise tax on high-cost health coverage
  - Applies to the excess of monthly cost of coverage over a specified threshold
  - Tax is paid by the insurer for insured plans, and by the employer or plan administrator for self-insured plans
  - Takes effect in 2018
- Employers will need to calculate the excise tax and report the excess benefit to the IRS and coverage providers
  - Potentially significant penalties may apply to employers who do not calculate the tax correctly, if there is an underpayment
- No guidance; many unanswered questions
- Absent a legislative fix, the Cadillac tax threshold is projected to dip below the minimum value threshold within 15-20 years.

Section 4980D: Failure to Meet Group Health Plan Requirements

- Preexisting section 4980D imposes an excise tax for any failure to meet the Code's group health plan requirements
- Section 9815 incorporates certain ACA provisions into the Code's group health plan requirements
- Requirements subject to 4980D tax include the insurance market reforms, including the prohibition on waiting periods that exceed 90 days
- Tax: $100 per day of noncompliance
- Taxpayers are to voluntarily report 4980D violations on Form 8928
- Many of the insurance reform mandates were effective for the first plan year beginning 6 months after date of enactment (September 23, 2010 and thereafter)
- Insurance reforms apply to group health plan offered by an employer

Market Reform Rules for Group Health Plans

- No waiting periods in excess of 90 days
- No lifetime or annual limits on "essential health benefits"
- Reduced out of pocket maximums
- No pre-existing condition exclusions
- Dependent coverage for adult children through age 26
- Coverage of preventive services with no cost sharing
- Non-discrimination rules for insured plans?
- Penalties for non-compliance include excise taxes ($100 per affected individual per day, up to $500,000), DOL penalties, and participant lawsuits

Additional Medicare Taxes

- Effective January 1, 2013
- 0.9% Medicare tax on high-wage employees
  - Threshold is $200K for single filers, $250K for married filers (not inflation-adjusted)
  - Withholding is required for wages from a single employer in excess of $200K, regardless of other employment or filing status
  - Employees may adjust their withholding allowances
- 3.8% Medicare tax on unearned income
  - Tax applies to net investment income, but only to the extent modified AGI exceeds the same $200K/$250K thresholds
  - Does not apply to wages
  - No employer withholding required

PCORI Tax/ Transitional Reinsurance Program

- PCORI fee for comparative effectiveness research (2012-2018)
  - Fee per "covered life" ($1 in 2012, $2 in 2013, indexed thereafter); first payment was due July 31, 2013
  - Tax paid by insurer for insured coverage, and by plan administrator for self-insured coverage
  - May not be paid from plan assets, with certain exceptions
  - Deductible as an ordinary and necessary business expense
- Transitional Reinsurance Assessment Program (2014-2016)
  - Fee per "covered life" was $63 for 2014; should be smaller for 2015, 2016; first payment was due January 15, 2015
  - Self-insured plans must pay the fee but are not entitled to any proceeds from the program
  - May be paid from plan assets
  - Deductible as an ordinary and necessary business expense

Medical Loss Ratio (MLR) Rebates

- Insurers that fail to meet minimum MLRs must issue rebates
  - For employer-sponsored plans, the rebate is paid to the employer sponsor.
- Allocation of rebate between employer and employees depends on governing documents, sources of premium payments
- Rebates that are ERISA plan assets must be used for the exclusive benefit of participants and beneficiaries
  - Failure to follow ERISA rules could trigger liability for plan fiduciaries
- Several permissible uses for rebates allocated to participants:
  - Reduction of future premiums
  - Benefit enhancements
  - Premium rebates – will be taxable to participants if the original premium payments were pre-tax

Code Section 162(m)(6)

- Reduces deductible limit from $1M to $500K
- Applies to "covered health insurance providers," subject to controlled group aggregation rules
  - Exception for self-insured plans
  - 2% de minimis exception may cover captive insurers
  - Generally does not apply to reinsurers
- Applies to all service providers; no performance pay exception
- Different timing rules for taking amounts into account
- "Revenue raiser" that could be applied more broadly as part of tax reform legislation

Limitations on HRAs

- Stand-alone HRAs cannot comply with certain market reform rules – prohibition on annual limits, no cost-sharing for preventive care
- HRA designs that work – Notice 2013-54
  - Retiree plans – some employers are offering HRAs in conjunction with private exchange coverage
  - HRAs integrated with group health plan coverage
    - Definition of "group health plan" in this context is not clear
  - HRAs that limit coverage to excepted benefits

Another Supreme Court Challenge

- In *King v. Burwell*, the Supreme Court will determine whether individuals who receive coverage through federally-facilitated exchanges are eligible for premium tax credits
- Case hinges on statutory construction and the scope of the IRS's regulatory authority
- If the Court determines that the tax credit is not available, people in up to 37 states will lose eligibility for subsidized coverage
- Individuals who are not eligible for the subsidy also cannot trigger 4980H excise taxes for their employers
- Oral argument set for March 4th, decision expected in June

IVINS, PHILLIPS & BARKER, founded by two of the original judges on the United States Tax Court in 1935, is the leading law firm in the United States exclusively engaged in the practice of federal income tax, employee benefits and estate and gift tax law. Our decades of focus on the intricacies of the Internal Revenue Code have led numerous Fortune 500 companies, as well as smaller companies, tax exempt organizations, and high net worth individuals to rely on the firm for answers to the most complicated and sophisticated tax planning problems as well as for complex tax litigation. We provide expert counsel in all major areas of tax law, and we offer prompt and efficient attention, whether with respect to the most detailed and intricate of issues or for rapid responses to emergency situations.

Disclaimer

This presentation, including any attachments, is intended for use by a broader but specified audience.
Unauthorized distribution or copying of this presentation, or of any accompanying attachments, is prohibited.
This communication has not been written as a formal opinion of counsel.