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EMPLOYEE BENEFITS AND EXECUTIVE COMPENSATION

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Patient Protection and Affordable Care Act Employer Penalty Provisions and Reporting Requirements to Take Effect in 2015

Introduction

On March 23, 2010, President Obama signed the Patient Protection and Affordable Care Act ("PPACA"). Since that time, the regulators have promulgated thousands of pages of regulations and other guidance implementing various provisions under PPACA. Of most pressing interest to employers are the Section 4980H "employer shared responsibility" provisions (sometimes called "play or pay") and Section 6055 and Section 6056 employer information reporting requirements. After publishing final regulations earlier in the year, the Treasury Department recently released long-awaited draft forms and instructions on the employer information reporting requirements.

Barring any further delays by the Treasury Department, the shared responsibility and reporting provisions will take effect in 2015. At this point, employers may want to revisit their strategy for minimizing risk under the shared responsibility requirements and should familiarize themselves with the information that will be needed to satisfy the reporting requirements in 2015. The first reports under Section 6055 and 6056 are not due until early 2016, but will be based on hours of service worked and medical coverage offered in 2015.

This newsletter first provides a brief overview of the employer shared responsibility penalty provisions, and then discusses the Section 6055 and 6056 reporting requirements.

Overview of Employer "Shared Responsibility" Penalty Provisions

The employer shared responsibility penalty regulations[1] are complicated and have been the subject of discussion for almost two years. Most employers should be familiar with the basics at this point. Beginning in 2015, an employer that is an "Applicable Large Employer Member" ("ALEM") may be subject to a shared responsibility penalty for failing to offer its full-time employees (those employees who average 30 hours of service per week over the course of the month, or 130 hours of service in a month) affordable, minimum value health coverage.

The regulations define an "hour of service" as each hour for which an employee is paid, or entitled to payment, for the performance of duties for the employer, as well as each hour for which an employee is paid, or entitled to payment by the employer for a period of time during which no duties are performed due to vacation, holiday, illness, incapacity (including disability), layoff, jury duty, military duty or leave of absence. For salaried employees, employers may calculate hours of service by using one of three methods: (1) actual hours of service, (2) a days-worked equivalency whereby an employee is credited with eight hours of service for each day in which the employee had at least one actual hour of service, or (3) a weeks-worked equivalency whereby an employee is credited with 40 hours of service for each week in which the employee had at least one hour of service.[2] For employees paid on an hourly basis, the employer must calculate actual hours of service from records of hours worked and hours for which payment is made or due.

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1 The final regulations are available at 79 Fed. Reg. 8544 (Feb. 12, 2014).

2 For this purpose, an anti-abuse rule applies, so that an employer cannot pick a method that would substantially understate hours of service (e.g., an employer cannot use the days-worked method for employees that regularly work three 12-hour days per week).

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An employer is considered an ALEM for a calendar year if the employer employed an average of at least 50 full-time employees and full-time equivalents on business days during the preceding calendar year.[3] To calculate the number of full-time equivalents at an employer, the hours of service of all part-time employees must be aggregated and divided by 120. There is a special transition rule for 2015 only that will allow some employers with 50-99 full-time employees and full-time equivalent employees to avoid paying a shared responsibility penalty in 2015.[4] Note that all employees of a controlled group are taken into account in determining whether the controlled group, as a whole, is an "applicable large employer." If the controlled group collectively meets the 50 full-time employee threshold, then each entity that is an employer in the controlled group is an ALEM, regardless of the number of employees that each entity employs. Penalties apply separately at the ALEM level. For example, in a controlled group consisting of a parent corporation with 30 full-time employees and two subsidiaries each having 15 full-time employees, each of the three companies is considered an ALEM, because on an aggregate basis, there were 60 full-time employees in the controlled group. If one subsidiary failed to offer affordable, minimum value coverage to a full-time employee and the employee triggered a penalty, the penalty would be calculated and payable at the subsidiary that employed the individual.

The penalties are not automatic, even when an ALEM does not offer coverage; a penalty is triggered only if a full-time employee does not enroll in employer-sponsored coverage, enrolls in coverage through an Exchange, and meets the Exchange income level criteria to qualify for a tax-credit or cost-sharing reduction ("Exchange Subsidy"). An employee can qualify for an Exchange Subsidy only if the employee was not offered employer coverage or if the coverage offered did not provide minimum value (i.e., the plan was not expected to pay at least 60% of charges covered by the plan) or was unaffordable (i.e., the employee's required contribution towards the cost of employee-only coverage exceeded 9.5% of his or her household income).

There are two categories of shared responsibility penalties—the Internal Revenue Code Section 4980H(a) penalty (the "A Penalty") and the Section 4980H(b) penalty (the "B Penalty"). Both are determined on a monthly basis. The A Penalty is triggered if, in a given month, an ALEM fails to offer coverage to "substantially all" (70% in 2015, 95% thereafter) of its full-time employees and their dependents, and a full-time employee not offered coverage enrolls in Exchange coverage and qualifies for an Exchange Subsidy. The monthly penalty is 1/12 x $2000 x (total number of full-time employees - 30). For 2015 only, the 30 employee reduction is an 80 employee reduction. Particularly for larger employers, the A Penalty is quite severe because it is based on the total number of full-time employees (less 30, or 80 in 2015), including those that were offered coverage.[5]

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3 In calculating the number of full-time equivalents, an employer should not credit more than 120 hours of service in a month to a part-time employee. Because the hours of service of part time employees are aggregated and divided by 120, this effectively means that a full-time employee, solely for purposes of determining applicable large employer status, is an employee who has at least 120 hours of service in a month.

4 An employer with 50-99 full-time employees/full-time equivalents will not face a penalty in 2015 only if it meets the following conditions:
(1) The Employer does not reduce the size of its workforce or hours of service in order to get under the 100 full-time employees/full-time equivalents threshold (reductions for bona fide business reasons are permissible).
(2) During a "coverage maintenance period" (February 9, 2014-December 31, 2015, for calendar year plans), the employer:

a. Continues to offer each employee who is eligible for coverage during the coverage maintenance period an employer contribution toward the cost of employee-only coverage that either:
   (i) Is at least 95% of the dollar amount of the contribution toward self-only coverage that the employer was offering on February 9, 2014; OR
   (ii) Is the same, or a higher percentage, of the cost of self-only coverage that the employer was offering on February 9, 2014.
b. If employer changes benefits coverage under the employee-only coverage offered, the coverage provides "minimum value" (has actuarial value of at least 60%).
c. The employer does not restrict the class of employees eligible from the class of those eligible on February 9, 2014.

Note that employers that qualify for this transition relief must still comply with the applicable 6055 and 6056 reporting requirements, discussed later.

5 In calculating the A Penalty, the 30 employee reduction (80 employee reduction for 2015 only) is allocated among all ALEMs in a controlled group of corporations based on the number of full-time employees at each ALEM. For example, if an applicable large employer group had two ALEMs, and each had the same number of full-time employees, then each ALEM would be entitled to a 15 employee reduction under the A Penalty.

The B Penalty applies if, in a given month, (1) an ALEM offers coverage to "substantially all" (70% in 2015, 95% thereafter)[6] full-time employees and their dependents, but a full-time employee who is not offered coverage buys coverage on an Exchange and qualifies for an Exchange Subsidy OR (2) an ALEM offers coverage to a full-time employee and his dependents, but the full-time employee declines the offer, buys coverage on an Exchange and qualifies for an Exchange Subsidy and the ALEM's offer of coverage to that full-time employee is either (i) unaffordable because the employee contribution for single coverage exceeds 9.5% of household income[7] or (ii) the health coverage offered does not satisfy a minimum actuarial value test (satisfied if the plan pays 60% of covered charges). The monthly B Penalty is 1/12 x $3000 x number of full-time employees who buy coverage on an Exchange and qualify for Exchange Subsidies. If the penalty amount calculated under the A Penalty formula described above would be less, then the ALEM would owe that lower amount.

Unlike the A Penalty, which is calculated based on the ALEM's total number of full-time employees, the B Penalty is calculated based only on the number of full-time employees who obtain coverage on an Exchange and qualify for the Exchange Subsidy. Most employers will want to be sure to avoid triggering the A Penalty and many have adjusted their health plan eligibility rules for 2015 to expand the employees to whom coverage is offered. If you have not assessed your potential exposure to the excise tax you should do so immediately.

Overview of Information Reporting

The reporting requirements under Code Sections 6055 and 6056 are designed to provide the IRS with the information it needs to apply the employer shared responsibility penalty provisions (i.e., to impose penalties on employers) and to provide individuals with coverage information that they need to avoid paying an excise tax under the individual shared responsibility requirements of PPACA (the "individual mandate"). The reporting requirements apply to ALEMs, with ALEM status determined in the same fashion as described above for the shared responsibility requirements. In the example above of a parent corporation with 30 full-time employees and two subsidiaries each with 15 full-time employees, each company would be an ALEM and each would have to file the required reports separately.

The reporting requirements under Section 6055 and Section 6056 are similar, but can apply independently of one another. Section 6055 requires information reporting by anyone that provides minimum essential coverage (i.e., medical coverage) to an individual during a calendar year, primarily to determine whether the individual is subject to a penalty based on the individual shared responsibility provisions under PPACA. In the case of insured group health plans, the insurance carrier will be responsible for satisfying the Section 6055 requirements. Section 6056 requires information reporting by the ALEM on the health care coverage offered to its full-time employees. This information is used to determine (1) whether an employee is eligible for an Exchange Subsidy and (2) whether the ALEM is subject to either the A Penalty or the B Penalty.

Employers that are not subject to the employer shared responsibility provisions of PPACA (i.e., are not considered an ALEM) and offer no coverage or only offer fully-insured coverage are exempt from these information reporting requirements. If applicable, the insurance carrier will file and report under Section 6055.

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6 The "substantially all" test applies separately to each ALEM. If an ALEM offers coverage to at least 95% (70% in 2015) of its full-time employees and their dependents, the ALEM will not be subject to the A Penalty.

7 Because an employer will not know its employees' household income, the regulators provided three affordability safe harbors in the final regulations. Under the "W-2" safe harbor, coverage will be deemed affordable if employee's required contribution for the employer's lowest cost self-only coverage that provides minimum value does not exceed 9.5% of the wages reported in Box 1 of the Form W-2 for that calendar year. Under the "rate of pay" safe harbor, coverage will be deemed affordable if the employee's required monthly contribution for the lowest cost self-only coverage that provides minimum value is not greater than 9.5% of an employee's hourly rate of pay x 130 hours, or, for salaried employees, 9.5% of the employees' monthly salary. And under the "federal poverty line" safe harbor, coverage will be deemed affordable if employee's required contribution for lowest cost self-only coverage that provides minimum value does not exceed 9.5% of the federal poverty line for a single individual.

In an effort to streamline the reporting process for Sections 6055 and 6056, the IRS created four separate forms: Form 1094-B; Form 1095-B; Form 1094-C; and Form 1095-C. Both the "B" and "C" versions of Form 1094 are "transmittal" forms used by the ALEM (or insurer) to transmit individual Forms 1095 to the IRS. Draft versions of the Forms are found here: Form 1094-B, Form 1095-B, Form 1094-C, and Form 1095-C, and draft versions of the instructions are available here: 1094-B and 1095-B Draft Instructions and 1094-C and 1095-C Draft Instructions. Employers primarily need to be concerned with the "C" versions of the Forms. Form 1095-C is a statement filed with the IRS for each full-time employee as well as any individual (including non-full-time employees) who enrolled in the employer's self-insured health plan. In addition to being filed with the IRS, Form 1095-C must also be furnished to each applicable individual. Form 1094-C is a transmittal form that reports employer-level data and is submitted together with all Forms 1095-C filed by the employer.

The manner in which the forms must be completed are dependent upon whether the ALEM offers fully-insured or self-insured coverage, or both.

1. ALEM offers only fully-insured coverage

   - The ALEM completes Parts I and II of Form 1095-C for each full-time employee, regardless of whether the employee is enrolled in coverage, and one Form 1094-C to transmit all of the 1095-Cs to the IRS.

   - The insurance carrier will provide information to employees that are enrolled in coverage and separately file with the IRS (using "B" versions of the Forms).

2. ALEM offers only self-insured coverage[8]

   - The ALEM completes Parts I and II of Form 1095-C for each full-time employee, regardless of whether the employee is enrolled in coverage. The ALEM must also complete Part III of Form 1095-C for any individuals (including non-full-time employees) who enroll in the ALEM's self-insured medical coverage. The ALEM will file one Form 1094-C to transmit all of the 1095-Cs to the IRS.

Example: Employer A offers a self-insured health plan that permits all employees, part-time and full-time, to participate. Employee X, a part-time employee, enrolled in the health plan during 2015. In addition to filing a Form 1095-C for each full-time employee, Employer A must also file a Form 1095-C for Employee X, indicating that Employee X enrolled in the self-insured coverage but was not a full-time employee.

   - Though not clear from the draft instructions, it is possible that ALEMs that offer self-insured coverage to retirees or who have COBRA qualified beneficiaries enrolled in self-insured coverage will need to complete Forms 1094-B (transmittal form) and 1095-B to report the coverage for such individuals. Stay tuned for guidance on this point.

3. ALEM offers both fully-insured and self-insured coverage

   - The ALEM completes Parts I and II of Form 1095-C for *all* full-time employees (even those that declined coverage or only enrolled in fully-insured coverage). The ALEM must also complete Part III of Form 1095-C for any individuals (including non-full-time employees) who enrolled in self-insured coverage. The ALEM will file one Form 1094-C to transmit all of the 1095-Cs to the IRS.

   - The insurance carrier will provide information to employees that are enrolled in coverage and separately file with the IRS (using "B" versions of the Forms).

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[8] Employers that are not subject to the employer shared responsibility provisions (i.e., are not an ALEM) under Section 4980-H but offer self-insured coverage will report on Forms 1094-B and 1095-B only for those employees who enroll in the employer sponsored self-insured health coverage.

Information Required

In order to be prepared to report in 2016, employers will need to ensure that they have properly collected information during 2015. While some employers may already have systems in place to track this data in-house, others may need to put systems in place. Employers that outsource their health plan enrollment/recordkeeping may need to coordinate with their enrollment recordkeeper and should begin discussing the reporting requirements with their recordkeeper now.

The following data will be needed for reporting:

- Identification of full-time employees for each calendar month[9]
- Identification of which ALEM is the common-law employer
- Name and EINs of the ALEM as well as any other members of the controlled group
- Identification of a person at each ALEM for the IRS to contact for more information
- Information regarding coverage offered to full-time employees
- The amount of each full-time employee's share of the lowest cost monthly premium (self-only) for coverage providing minimum value offered to that full-time employee, by calendar month
- Enrollment data by calendar month
- The names for all individuals (employees, covered dependents, spouses, domestic partners, etc.) enrolled in self-insured coverage
- Social security numbers for all individuals (employees, covered dependents, spouses, domestic partners, etc.) enrolled in coverage (whether it be fully-insured or self-insured); ALEMs may want to consider soliciting social security numbers during the annual enrollment process if they do not already have such information

Alternative Reporting Methods

The regulations provide for two "alternative" reporting methods that presumably are intended to simplify the information reporting requirements. At most, however, these alternative reporting methods simply permit ALEMs to avoid completing certain sections of Forms 1094-C and 1095-C. ALEMs that use an alternative reporting method will still have to gather all of the information necessary to complete the full 1094-C and 1095-C forms. Because these methods do not actually streamline an employer's data tracking requirements, we generally do not recommend their use.

1. Qualifying Offer Method

   To use the Qualifying Offer Method, an ALEM must certify that a "qualifying offer" was made to one or more full-time employees and their spouses and dependents. A qualifying offer is an offer of minimum essential coverage providing minimum value at an employee cost for employee-only coverage not exceeding 9.5% of the federal poverty level (approximately $1,100 annually in 2015).

   For full-time employees to whom a qualifying offer is certified as made for all 12 months of the calendar year, the ALEM will not have to report the actual dollar amount of the employee-only contribution on Form 1095-C.

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[9] As discussed earlier, an employee is full-time for a month if the employee has 130 hours of service or more in the month. ALEMs should keep in mind that an "hour of service" does not only include hours worked, but also hours for which an employee is paid, or entitled to payment by the employer for a period of time during which no duties are performed due to vacation, holiday, illness, incapacity (including disability), layoff, jury duty, military duty or leave of absence.

Full reporting is required for full-time employees to whom the ALEM does not make a qualifying offer. Since the ALEM is still required to maintain records regarding the dollar amount of the employee-only contribution and to track hours of service, this method does not appear to simplify much.

2. 98% Offer Method

   If the ALEM certifies that it offered affordable minimum essential coverage providing minimum value to at least 98% of its employees (and their dependents) who are required to be furnished a Form 1095-C (i.e., 98% of full-time employees and those non-full-time employees that are enrolled in self-insured coverage), then the employer is not required to report the total number of full-time employees on Form 1094-C and is not required to distinguish between full-time and non-full-time employees on Form 1095-C.

As with the Qualifying Offer method, the employer must still track hours of service, so this method does not provide much "relief" for the employer.

Conclusion

Employers that have not done so already should take steps now to plan for the employer shared responsibility provisions that will take effect in 2015. To that end, employers should determine whether they are an ALEM subject to the penalties, and if so, review their plan eligibility provisions and employee premium contribution requirements to gauge their penalty risk.

Because the reporting requirements are complex and require the collection of a large amount of information, ALEMs should also begin assessing whether they currently collect and maintain such data. Early coordination with any third-party recordkeepers will avoid delays in filing Section 6055 and 6056 returns by the 2016 deadline.

Should you have any questions regarding this LEGALcurrents®, your compliance with the employer shared responsibility provisions and reporting requirements, or any other matter, please do not hesitate to contact any member of our the Employee Benefits and Executive Compensation Practice Area at (585) 232-6500. ■

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