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INFORMATION MEMO
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2015 Ends With a Flurry of ACA Activity

Employers were treated to a number of Affordable Care Act (ACA) developments just in time for the holidays and to ring in the New Year. Many of the developments are welcome news for employers, including an extension of the ACA reporting due dates and a delay in the implementation of the so-called "Cadillac Tax." The IRS also provided much needed clarification regarding the application of various provisions of the ACA to employer-provided health coverage, including guidance regarding the effect of opt-out arrangements, flex contributions and health reimbursement arrangements (HRAs) on the determination of whether an offer of coverage is affordable under the ACA's employer shared responsibility (ESR) rules, and clarifying guidance regarding how the ACA's market reforms apply to HRAs. The highlights of these developments are summarized below.

ACA Reporting Extension

As 2015 drew to a close, many employers found themselves working diligently to prepare the appropriate ACA reporting forms in anticipation of a looming February 1, 2016 distribution deadline. The IRS gave employers a slight reprieve in the form of a two month extension. Under the extension, the deadline to provide individuals with Forms 1095-B and 1095-C has been extended from February 1, 2016 to March 31, 2016. The due date for filing Forms 1094-B, 1095-B, 1094-C and 1095-C with the IRS has been extended from February 29, 2016 to May 31, 2016, if not filing electronically. If filing electronically, the deadline is extended from March 31, 2016 to June 30, 2016.

While the delays should give employers who were playing "catch up" with respect to the ACA reporting requirements a much needed break, employers who were on schedule to complete the Forms under the prior deadlines should consider taking advantage of the extra time to ensure that their reporting process has resulted in Forms that are accurate and complete.

Cadillac Tax Delay

On December 18, 2015, President Obama signed into law the Consolidated Appropriations Act, 2016 (Act). The Act included a two-year delay on the effective date of the 40 percent excise tax imposed on employer-sponsored health coverage that exceeds certain limits, commonly referred to as the "Cadillac Tax." The delay extends the effective date of the Cadillac Tax from January 1, 2018 to January 1, 2020. While the delay further clouds the future of the Cadillac Tax (which has been the subject of repeal discussions in Washington), for the time being, employers should continue to review their health insurance plans to determine whether they may be subject to exposure under the Cadillac Tax and plan appropriately for design changes that may be required to avoid the tax prior to the new effective date.

IRS Notice 2015-87

IRS Notice 2015-87 (Notice) provides guidance on a number of ACA compliance issues with respect to various health plan arrangements. The scope of the Notice is broad, covering a wide range of ACA issues affecting health plan sponsors. This memorandum focuses on two issues covered in the Notice: (1) how opt-out payments, flex-credits, and contributions to HRAs affect the affordability of an employer's health coverage offer for purposes of the ESR and ACA reporting rules; and (2) clarifications regarding the application of the ACA's market reforms to HRAs.

Affordability

With the ACA reporting deadline looming, many employers have just begun to dig into the details of when an offer of coverage is considered "affordable" for purposes of the ESR and reporting rules under the ACA. The ESR rules generally require applicable large employers to offer affordable health coverage that provides minimum value to full-time employees in order to avoid a potential penalty. The regulations provide that an offer of coverage is considered affordable under a "safe harbor" rule if the lowest cost, self-only coverage option offered to employees does not exceed 9.5% of a specified threshold (e.g., wages reported on Form W-2).

The Notice clarifies a number of issues regarding the affordability determination for purposes of the ESR and ACA reporting requirements, including:

- **Opt-Out Payments.** The treatment of opt-out payments (i.e., payments that are offered to employees in exchange for waiving group health insurance coverage) has been a vexing issue for many employers. While the regulations provide that affordability for purposes of complying with the ESR rules is based on the employee's "required contribution" for the applicable health insurance premium, the IRS has previously informally indicated that opt-out payments have the effect of increasing an employee's contribution for health coverage above the normal salary reduction amount for the coverage. As an example, if single coverage for the lowest cost plan of an employer costs $200 a month, and an employee is offered an additional $100 per month in taxable wages if he or she declines the coverage, the IRS' position is that the offer of the $100 has the economic effect of increasing the employee's contribution for the coverage because the employee must forego the $100 if coverage is elected. Accordingly, in this example, the employee contribution towards the cost of coverage would be $300 because the employee must forego $100 per month in compensation, in addition to the $200 per month in salary reduction.

  The Notice provides that the IRS intends to formalize this position in future regulations with respect to unconditional opt-out arrangements (i.e., an arrangement that conditions the opt-out payment solely upon the employee declining coverage without any other conditions, such as a requirement to provide proof of coverage from a spouse's employer). Prior to that date, employers are not required to increase the amount of an employee's required contribution by the amount of an opt-out payment for "affordability" purposes, provided that the opt-out arrangement was adopted prior to December 16, 2015.

  Because the treatment of opt-out payments may affect the premium tax credit eligibility of an employee who has enrolled in Marketplace (Exchange) coverage, the IRS indicated that, until further guidance becomes effective, employees may treat such payments as increasing the employee's required contribution (thereby increasing the likelihood that the employee will be eligible for a premium tax credit). This rule applies both with respect to unconditional opt-out payments and conditional opt-out payments where the employee can demonstrate that he or she meets the applicable condition to receive the opt-out payment.

- **Flex Contributions to a Cafeteria Plan.** The Notice provides that flex contributions under an employer's Internal Revenue Code (Code) Section 125 cafeteria plan reduce the amount of an employee's required contribution for purposes of the ESR rules, if the amount constitutes a "health flex contribution." In order to be considered a health flex contribution, the employee: (i) may not opt to receive the amount as a taxable benefit; (ii) may use the amount to pay for minimal essential coverage; and (iii) may use the amount exclusively to pay for medical care, within the meaning of Section 213 of the Code. Flex contributions that are not health flex contributions do not reduce the employee's required contribution. For example, a flex contribution that is available for health care coverage but could also be received in cash does not have the effect of reducing an employee's contribution. Health flex contributions are treated as made ratably for each month of the contribution period.

  Employers who have been treating non-health flex contributions as reducing an employee's required contribution for purposes of the ESR rules are given transition relief. Under the transition rule, for plan years beginning prior to January 1, 2017, a flex contribution that is not a health flex contribution will be treated as reducing the amount of an employee's required contribution. The relief is not available for a flex contribution arrangement offering non-health benefits that is adopted after December 16, 2015 or that substantially increases the amount of the flex contribution after December 16, 2015.

  Additionally, for ACA reporting purposes, for plan years beginning prior to January 1, 2017, an employer who maintains a non-health flex arrangement that is eligible for the transition relief may choose to reduce the employee's required contribution attributable to the flex contribution amount for purposes of the information reporting required on line 15 of Form 1095-C. Because this reduction could impact an employee's eligibility for a premium tax credit, the IRS has encouraged employers not to reduce the employee's required contribution on line 15 based on a non-health flex contribution. Employers who do not reduce the contribution on line 15 and are contacted by the IRS regarding a potential assessable payment due to the employee's receipt of a premium tax credit will have the opportunity to demonstrate that the employee would not have been eligible for the tax credit if the employer had reduced the employee's contribution by the non-health flex credit amount.

- **HRA Contributions.** Under the Notice**,** HRA contributions that may be used by an employee to pay the premiums for employer-sponsored health plan coverage are counted towards the employee's required contribution and therefore reduce the amount of the employee's required contribution for affordability purposes, provided the HRA is integrated (see below for a general discussion of the integration rules). In order for these amounts to be counted towards the employee's required contribution, the annual HRA contribution must be stated in the HRA plan or otherwise be determinable within a reasonable period of time prior to when the employee is required to make a decision to enroll. The HRA contribution is treated as made ratably for each month of the period to which it relates. This rule applies regardless of whether the employee uses the HRA to pay his or her share of contributions for the health plan coverage (i.e., the reduction is still permissible even if the employee uses the HRA contributions to pay for co-pays, deductibles, etc. and not health plan premiums).

HRAs

In prior guidance (IRS Notice 2013-54), the IRS addressed a number of important issues related to the application of the ACA's market reforms to HRAs. The market reforms cited in the prior guidance as problematic with respect to HRAs were: (i) the requirement that a group health plan may not establish an annual limit on the dollar amount of benefits that are considered essential health benefits; and (ii) the requirement that non-grandfathered group health plans must provide certain preventive services without imposing any cost-sharing requirements for these services. IRS Notice 2013-54 established the general rule that an HRA covering active employees satisfies these market reforms if it is integrated with another group health plan that satisfies the reforms, but will not be considered integrated if it may be used to purchase individual market coverage, including Marketplace coverage. The Notice provided clarification regarding these rules in the following circumstances:

- **Retiree-Only HRAs May be Used to Purchase Individual Market Coverage.** The Notice reaffirmed prior guidance indicating that an HRA that covers fewer than two participants who are current employees (such as a retiree-only HRA) is not subject to the market reforms. Accordingly, such a plan may be used to purchase individual market coverage, even if the amounts available to the retiree are determined in whole or in part by amounts credited during a period in which the individual participated in an integrated HRA covering active employees. However, any month in which such HRA funds are available, the participant in the HRA will not be eligible for a premium tax credit with respect to the purchase of Marketplace coverage for that month.

- **Unused Amounts Credited to HRA While Integrated May Not be Used to Purchase Individual Coverage.** Amounts that were credited to an HRA covering active employees while the HRA was integrated with other group health plan coverage generally may be used to reimburse medical expenses in accordance with the terms of the HRA after an employee ceases to be covered by the other integrated health plan coverage. However, these credited amounts may not be used to purchase individual coverage after the employee covered by the HRA ceases to be covered by the other integrated group health plan coverage. Accordingly, an HRA covering active employees may not permit the purchase of individual market coverage, even with respect to unused amounts credited to an employee while the HRA was integrated with other group health plan coverage.

- **Amounts Credited to an HRA Prior to January 1, 2014.** The Notice reaffirmed that amounts credited to an HRA prior to January 1, 2014, including any amounts credited prior to January 1, 2013 and any amounts that were credited during 2013 under the terms of an HRA in effect on January 1, 2013, may be used after December 31, 2013 to reimburse medical expenses in accordance with those terms without causing the HRA to fail to comply with the market reforms. If the HRA terms in effect on January 1, 2013 failed to define a set amount to be credited during 2013, the amounts credited during 2013 may not exceed the amounts credited for 2012 and may not be credited on an earlier schedule or faster rate than the crediting schedule or rate that applied during 2012.

- **Family HRA Integration.** HRAs may be designed to reimburse the eligible medical expenses of an employee's spouse and/or dependents (Family HRA). The Notice clarified that a Family HRA is permitted to be integrated with an employer's other group health plan for purposes of the market reforms only as to the individuals who were enrolled both in the HRA and the employer's other group health plan. If an employee's spouse and/or dependents are not enrolled in the employer's other group health plan coverage, their coverage is not considered integrated, and as a result, the HRA will fail to satisfy the market reforms. However, under a transition rule, the IRS will not treat an HRA and group health plan that would otherwise be integrated based on the terms of the plan as of December 16, 2015 as failing to be integrated for plan years beginning before January 1, 2017, solely because the HRA covers the expenses of a spouse and/or dependent who is not enrolled in the employer's other group health plan. But, the employer will be responsible for reporting the HRA coverage as minimum essential coverage for each individual covered by the HRA who is not also enrolled in the employer's group health plan.

Conclusion

These ACA developments prove once again that the only thing predictable about ACA guidance is that it is unpredictable and subject to change. The ACA reporting delay provides applicable large employers subject to the ESR rules with some welcome additional time to complete and assess the accuracy of their reporting forms. The guidance in the Notice regarding health coverage affordability determinations for applicable large employers who maintain opt-out arrangements, flex credits, or HRAs should help employers assess how to complete line 15 of Form 1095-C and understand their potential exposure under the ESR rules. Also welcome was an indication in the Notice that the IRS will not impose penalties for ACA reporting failures, provided that the employer can show that it has made good faith efforts to comply with the information reporting requirements.

Finally, as mentioned above, in addition to the issues addressed in this memorandum, the Notice addressed a wide array of other issues affecting group health plan sponsors. We will provide guidance regarding these ACA developments in future updates.

If you have any questions about this memorandum, please contact any member of our Employee Benefits and Executive Compensation Practice Group listed below.

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