ACA IRS compliance and reporting

Year-one retrospective

Building a better working world

Even though the Affordable Care Act (ACA) was signed into law more than five years ago, 2015 was the first year employers were required to report their compliance with the Act's Employer Mandate to their employees and the IRS.

Statutory IRS ACA reporting requires employers to gather data from a number of internal sources and possibly outside business partners, and then analyze the data against the IRS requirements for ACA compliance. This task is complicated by the ACA's prescriptive requirements and definitions, which in many cases differ from accepted industry vernacular.

The IRS had hoped that employers would use 2015 to establish a repeatable process for completing IRS Form 1095-C for employees and for transmitting the Form 1094-C, another form with important information about employee counts for each reporting entity, along with the entities' associated Forms 1095-C, to the IRS.

Given the complexity of this undertaking, the IRS offered several forms of transition relief in 2015, including:

- **The need for employers to offer coverage to only 70% of the full-time workforce of each employing entity in order to avoid potential penalties under IRC Section 4980H(a)**
- **A waiver of accuracy-related penalties if the employer made a "good faith" effort to comply on promptly filed and furnished Forms**
- **An extension to each filing deadline (March 31 for furnishing Forms 1095-C to employees and June 30 for transmitting Forms 1094-C and 1095-C to the IRS, if filing electronically)**

Employers have made huge strides in getting their ACA compliance processes in order, but the law's complexity remains a challenge. Even employers who offer coverage to virtually all of their employees have been blindsided by the complexity of the data collection and analysis process necessary for ACA compliance and reporting.

In addition, 2016 will present even greater challenges for employers, as several forms of the transition relief available for 2015 reporting no longer apply:

- **An employer needs to offer health care coverage to at least 95% of its full-time workforce starting with its plan year that begins in 2016.**
- **The relief for accuracy-related penalties no longer applies.**
- **The filing deadlines revert to the statutory deadlines of January 31 for Forms 1095-C, and March 31 for Forms 1094-C (for employers filing electronically and not requesting an extension).**
- **Employers must evaluate and respond to the premium tax credit notices that are now being issued by the federally managed Health Insurance Marketplace.**

Some employers recognize that what may have seemed like a simple, straightforward process may actually expose them to significant financial risks, and some may be looking to re-evaluate their process and business partners. But everyone will be asking – "Is the process I used in 2015 able to withstand the additional scrutiny required for 2016 reporting?"

Employee classification — known knowns, known unknowns and unknown unknowns

One of the basic tenets of the ACA that proved problematic for many employers was the traditional "facts and circumstances" test for determining which of their workers are considered employees under the ACA.

The ACA uses the common-law standard for defining a company's employees, which shines a light on two unique groups of workers that may not have been historically offered benefits coverage by employers: contractors and contingent workers. Both of these groups are used in a variety of capacities — IT support, interns, on-call nurses, seasonal employees, writers or marketing talent, temporary contract labor, and other IRS Form 1099 workers.

Confirming that an employer's contingent workers are not common-law employees means evaluating the facts and circumstances surrounding each contingent worker, establishing internal protocols for hiring contractors, and reviewing the language used in staffing agency contracts. These steps can help employers identify a contingent worker blind spot.

Once an employer has identified the ACA-defined employee population, it needs to measure whether these employees are full-time. ACA regulations outline the process for employers to use to determine whether both their current employees and new hires are considered "full-time," a process commonly referred to as "full-time determinations (FTDs). However, many employers have yet to make these determinations part of their onboarding and annual enrollment processes in the manner required by ACA regulations.

This calculation will become more critical in 2016, since failing to offer health care coverage to at least 95% of the full-time employees in a reporting entity in a given month can subject the employer to a non-deductible excise tax penalty equaling the product of $180 (or $2,160 if applicable for all 12 months in the reporting year) and the total number of full-time employees in an entity (the IRC Section 4980H(a) penalty or "A Penalty"). In addition, failing to offer these employees coverage deemed "affordable" or providing "minimum value" can subject the employer to a 270 per-month (or $3,240 if applicable for all 12 months in the reporting year non-deductible excise tax on each employee who receives a premium tax credit from a state exchange (the IRC Section 4980H(b) penalty or "B Penalty").

Many employers have taken false comfort in believing that their offer of coverage to their full-time employees eliminates the need to perform FTDs. The determinations, however, can be nuanced, like much of the ACA.

In a recent roundtable discussion, Ernst & Young LLP professionals discussed the experiences they've had with employers that have had to contend with the new regulations and specific implications.

"Many of the employers we work with believed they had a good handle on FTDs," said Michael Toth, a senior manager in Ernst & Young LLP's ACA practice, serving financial services companies. "But when you start to discuss the nuances of the FTD practice, they are often surprised and want to learn more details."

In order for an employer to fully comply with the ACA FTD rules, they need to evaluate each employee throughout their employment tenure, often using different methods or different periods that sometimes overlap. The process is the same regardless of whether an employer offers self-insured or fully insured coverage.

- **Initially, the employer needs to decide which of two permissible measurement methods it will use to make its FTDs — the Monthly Measurement Method or the Lookback Measurement Method. The Monthly Method offers an employer more flexibility if it has employees that frequently switch between full-time and part-time schedules. However, the FTDs can only be determined after the fact. The LBM permits an employer to apply FTDs prospectively, but at the expense of an employee retaining full-time status for the length of a "stability period."**
- **The employer is permitted to use different measurement methods or measurement periods for different groups of employees. However, employees can only be grouped based on specific criteria outlined in the regulations: salaried vs. hourly employees, union vs. non-union, working in different states, and working for different legal entities.**

- **At the time of hire, an employer using the Lookback Measurement Method needs to determine whether the employee is expected to average 30 hours of service (which includes, for instance, paid time off and an adjustment for certain types of leaves of absences) per week or 130 hours of service per month, the ACA definition of a full-time employee. If the employee meets this standard, the employer would need to offer the employee the opportunity to enroll in health care coverage no later than the first day of the first calendar month immediately following the first three full calendar months of employment in order to avoid a potential penalty.**
- **An employer electing the Monthly Measurement Method has three full calendar months to offer coverage to an employee who measures full-time. The three full months includes the first month the employee measured full-time, and this three-month period may only be applied once per period of employment. A new period of employment begins only after the employee has incurred a break in service. This means that if the employee moves between full-time and not full-time status without a break in service, an offer must be in place in those months the employee measures full-time to avoid a potential penalty.**
- **An employer is required to track and document hourly employees' actual hours of service, but is allowed to use equivalencies (e.g., 40 hours per week or 8 hours per day) to substantiate the hours of service for employees who are not paid on an hourly basis.**
- **In the event an employer is using the Lookback Method to measure its employees to determine full-time status, employees who are reasonably expected to be full-time at time of hire should be measured monthly until they enter a "standard stability period" following the completion of a "standard measurement period."**

For employees not hired into full-time positions, the process for determining whether they should be classified as full-time employees is even more complex. For hourly employees, the employer needs to track actual hours worked, in addition to paid time off and periods of special leave, to determine whether they averaged 30 hours of service per week.

The Monthly Measurement Method can cause an employee's status and, therefore, the need to offer health care coverage, to change on a monthly basis. To add to the complexity, the determination cannot be finally completed until after the month is completed. Therefore, to avoid the employer shared responsibility excise tax, an employer will either need an extremely good insight into which of its employees may tend to work 30 hours per week or an extremely accurate scheduling and time management process.

The Lookback Method (LBM) allows employees to be measured over a period of up to 12 months. After an employee is measured over the lookback period, they enter a stability period of equal length. For instance, if the employee is determined to be full-time, the employer needs to offer coverage during the entire stability period or potentially be subject to employer shared responsibility penalties. For 2016 reporting, employers need to determine their employees' status using data for those employed or hired from as far back as 2014.

"The Monthly Method is far easier to implement, but can create an operational nightmare if an employer has employees whose hours of service fluctuate above and below the 30 hours a week threshold," said Ann Bradshaw, Ernst & Young LLP's ACA Leader for the Southwest Region. "The Lookback Method can provide greater predictability, but is also far more challenging to compute."

It should be noted that for all employees, the hours counted include hours of service at all entities under the controlled group. Employees who work in multiple entities during the year may need to receive multiple Forms 1095-C. The employee is allocated to the entity for which he had the most hours of service in a given month.

In the end, employers must carefully consider several questions that potentially impact their ACA compliance and reporting process, including the following:

- **Do they understand the entire process and nuances for measuring their employees according to ACA regulations?**
- **Did they choose the right method for their workforce population?**
- **Are they tracking hours for alternative compensation arrangements?**
- **Do they have both the necessary data and documentation regarding their process to demonstrate compliance tracking and measurement?**

Data dilemmas — finding new ways of working together

A problematic area for employers is gathering and analyzing the data needed to properly issue the IRS Forms. In many cases, employers significantly underestimate the time and complexity involved.

Data is typically housed with both in-house sources and outside business partners, including payroll provider(s) and one or several health care, COBRA, disability, leave of absence and retiree benefit administrators. This can present four major challenges.

1) Data integration. Existing in-house and business partner data processes were often designed to meet a sole purpose. In contrast, the ACA requires the aggregation and then integration of these data sources.

"The ACA requires a level of internal coordination far greater than the typical process for reporting," said Stephanie Swann, Ernst & Young LLP's ACA Indirect Tax National Markets Leader. "Having a project manager who can get everyone to move in the same direction with the same quality of information is critical to developing an efficient process for ACA."

2) Data formatting. IT teams cannot just send data in the format they have on hand. Instead they must become conversant in ACA regulations and vernacular and often provide the data in a new format mandated by a business partner.

"For most employers, HR and Benefits departments had a strong understanding of the ACA and its terminology in order to make their plans compliant," said Bradshaw. "But for purposes of reporting, a client's data team plays a critical role, which requires it to develop the same appreciation of the ACA. The learning curve in many cases was pretty steep.

"IT team members often had to rework data into a specific format so it could be analyzed using tools developed by third-party business partners to properly assign the codes for the Forms 1095–C. This required the data teams to develop customized queries to extract the specific slice of data needed. These new data requests in turn often forced employers to re-prioritize IT resources and timelines, resources which in many cases work with schedules established months in advance with little capacity for additional projects."

3) ACA indoctrination. The regulations also required integration of COBRA, disability and leave of absence into the reporting process, with the consequent need to educate the people responsible for those areas on the ACA. Many employers and their third-party plan administrators were overwhelmed by the need to create new or rerun existing reports, which led to delays and added time pressure. As important, the data teams needed time to coordinate with their counterparts in HR/Benefits to evaluate the accuracy of data or system logic producing the data results.

"It usually takes more time to build the requisite ACA reporting data file than you can expect or imagine," said Toth. "The ACA has its own unique lexicon. You need to speak ACA. You need to translate your data into ACA."

The most effective advisory support model offers a variety of backgrounds, including former IRS and U.S. Treasury officials who developed the ACA legislation and regulations, seasoned benefits professionals from corporate and consulting firms, and tax professionals who understand the finer points of the ACA and who can counsel employers on how to handle the many thorny ACA reporting issues.

"When we started to dig deeper into the regulations, it became clear that the devil is in the details," said Swann. "That's why we use — and always recommend — a dedicated overall project manager, subject-matter professional and ACA data specialist as a core team to know … or in our case, to coach our clients on … what they need to do. Building on the strength of our core teams, we are undertaking efforts to streamline further our ACA process so that we can make it as easy as possible for our clients to comply with the more stringent 2016 ACA requirements."

4) Proofreading and quality checks. The production of the Forms 1095-C and 1094-C could expose data flaws and shortcomings that needed to be fixed so inaccurate information was not distributed to the employees and transmitted to the IRS.

"Many employers that don't update their data annually or by year-end, or don't track dependent Social Security numbers, will find that production of the Form 1095-C is a day of reckoning for the accuracy of their data," said Toth. "Once these data issues are uncovered, the HRIS team needs to scrub the data and resend it to the vendor, who produces a new Form 1095-C that will then be re-reviewed by the HR/Benefits team to make sure it produces an expected or at least explainable result."

"I worked with a lot of clients this year, and those with smooth transitions had several things in common," said Bradshaw. "It made a huge difference when a cross-functional team worked together through the implementation process. The data people at those employers gained an understanding of how the data was to be used because they teamed with the Compensation and Benefits people who understood the intricacies of their health plans and origin of the information placed into the HRIS system. These blended teams also included representatives from tax, legal and payroll, because we found critical decisions often involved determinations by these groups."

Getting the indicator codes correct is complicated

Determining an employer's common-law employees and whether they are considered full-time under the ACA is just the lead-up to the essence of ACA compliance and reporting — analyzing the data so it can be properly reported on Forms 1095-C before they are sent to employees. The IRS created 18 distinct indicator codes that show the type of coverage for which the employee was eligible, their employment status, and whether that employee enrolled in coverage or was subject to an affordability safe harbor. For 2016, the IRS retired indicator codes that applied only to 2015 transition rules but added two new codes for employers making conditional offers to spouses which will only increase the complexity.

Each indicator code is the result of multiple factors and nuances, which can vary based on the employee's employment status and the parameters of their health care coverage, which can change from month to month. Even employers with predominantly full-time workforces that offer health care coverage to most of their employees — including those not required to be covered under the ACA — can have multiple indicator code combinations on their employees' Forms 1095-C throughout the year.

In addition, several attributes of a company's onboarding and termination process can lead to unique reporting results. For example:

- **Date health care coverage is offered: Employers should track the date the enrollment packet was mailed to the employee … something that may not have been captured in the past.**
- **Date health care coverage begins for new hires and rehires: Depending on your coverage policy, coverage can begin on the date of hire, the first day of the month following hire, after a probationary period or some other date.**
- **Date health care coverage ends: When a terminated employee leaves, coverage might end on the date of termination, on the last day of that month or perhaps some other date. Some employers will terminate coverage when an employee transfers into a new benefits-ineligible position. The dates coverage is terminated under those circumstances also need to be documented.**
- **Tracking hours: ACA requires tracking of actual hours worked as opposed to scheduled hours.**
- **Paid time off: Consider the calculation of hours an employee is paid or entitled to payment due to vacation, holiday, illness, incapacity (including disability), layoff, jury duty, military duty or leave of absence.**
- **Unpaid leave: If using LBM, adjust the hours of service calculation for "special" periods of unpaid leave, specifically jury duty, military leave or FMLA.**
- **Interns and short-term workers: The employer must track hours of service for paid interns and seasonal workers. How are they being measured?**

"More than a few of the employers I worked with were surprised by the number of combinations that were developed on their Forms 1095-C," said Toth. "Their initial reaction was often, 'Well, that's not right,' and the more deeply we dug, the more clients came to realize the anomalies were due to data they were providing."

Transmitting forms to the IRS

As maddening as the process for developing the Forms 1095-C could be, the process for transmitting them with the Form 1094-C transmittal to the IRS can be equally challenging. The development of a new electronic transmittal process named the Affordable Care Act Information Returns (AIR) program was a major undertaking for the IRS, but necessary given the volume and complexity of the data that was to be received.

"The volume of ACA reports will likely exceed any other type of reporting the IRS has received for a specific program to date," said Raymond Grove, a senior manager in Ernst & Young LLP's Tax National ACA operations. The AIR process requires a transmitter to sign up and then successfully establish a test link that must be approved by the IRS before the transmitter can transmit forms on behalf of an employer. The process for becoming an approved transmitter can be time-consuming and challenging, with some business partners ultimately deciding that the employer is in the best position to establish the link and have responsibility for transmitting data to the IRS. Unfortunately, that last-minute revelation left many organizations without a clear path to fulfill their reporting obligations in a timely manner for 2015 reporting.

Many employers were surprised to find that files they submitted were rejected or partially accepted since the information submitted did not match the proper legal name and FEIN information the IRS had on file. Employers also found that some employee records were rejected or partially accepted due to a disagreement between an employee's name and tax identification number (TIN) submitted and the IRS files; this occurred despite many employees using the same name and TIN they used to submit W-2 data, which they had previously checked against the Social Security Administration's database.

"Anticipating some of these first-year system issues, we purposely designed our process to be in-line with the manual user interface instead of application-to-application," said Grove. "This gave our employers more direct control and responsibility for the consistency of data being transmitted. I suspect any company that relied on an application-based system protocol ran into far more quirks than we've seen with the AIR system."

Looking forward — the final frontier

For all of their good intentions, great expectations and best efforts, many employers still raced to complete ACA implementation right up to the IRS extended filing deadlines, and in some cases, despite best efforts, beyond. The ACA's definition of compliance is very broad. The decision whether to keep compliance in-house, purchase software, or engage a third-party business partner to handle ACA compliance and reporting is a complex one with the need for careful coordination regardless of your approach.

"Employers with well-integrated teams had the best and most efficient ACA compliance and reporting process," Bradshaw said. "It was tough for those whose data team operated in a vacuum. In this environment, HR and benefits departments have to rely on the data teams and vice versa. In the end, formation of strong in-house cross-functional teams is at the heart of many ACA compliance success stories."

Even as employers wrestle their systems into shape and begin to comply with the law, the ACA continues to evolve. The possibility of significant financial penalties fines — both in the form of excise taxes and penalties for filing inaccurate information or not filing forms by the filing deadlines — is real. Employers also may have to respond to information requests from state and federal health exchanges as well as the IRS.

"The ACA compliance process has not yet been fully deployed," said Swann. "State marketplaces administered by the federal government are just starting to issue Exchange Notices. And after completing its reconciliation or analysis, the IRS may issue assessments many months after the filing deadline. This can possibly give employers a false sense of security that their compliance process is adequate." Excise tax notices to employers for 2015 are not expected to be issued until sometime in 2017.

In these first few years of compliance, the potential for error by both employers and regulators is high. As a result, employers will want to evaluate the accuracy of any potential assessments, recognizing that they will have a tight window to appeal if premium tax credits or IRS penalties are issued in error.

At the same time, most employers continue to look at ways to mitigate health care costs. Cost-saving opportunities may include re-evaluating subsidy levels in light of safe harbors and penalty thresholds and educating employees on coverage alternatives outside of employer-sponsored programs, including Medicaid.

In any event, the rules and calculations regarding FTDs and how employers are to complete Forms 1095-C continue to shift as the IRS continues to amend rules and provide additional guidance. Most observers expect this complex law to continue to evolve over the coming years, with profound changes always a political possibility. Nevertheless, the ACA is the law of the land, and employers need to be prepared to comply or face the risk of potentially heavy penalties.

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SCORE No.02620-161US
ED 1608