Insights for companies on their ACA journey

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In the years since President Obama signed the Patient Protection and Affordable Care Act ("ACA") into law, the priority of large employers (i.e., employers that employed an average of at least 50 full-time equivalent employees on business days in the preceding calendar year) has been to ensure that their health plan offerings meet three main requirements to satisfy the Employer Shared Responsibility provisions ("Employer Mandate"):

1) Minimum essential coverage
2) Minimum value
3) Affordability

However, the ACA requires employers to do much more than simply offer coverage that meets these requirements. One of the most onerous requirements of the ACA is the information reporting mandated by Sections 6055 and 6056.

On December 28, 2015 the IRS issued Notice 2016-4, automatically extending the deadline to furnish forms to employees from February 1, 2016 to March 31, 2016. The deadline to file forms with the IRS was also extended to May 31, 2016 (for paper forms) and June 30, 2016 (for electronic forms) from the original deadlines of February 29, 2016 and March 31, 2016, respectively. Some employers did not utilize the extra time to furnish forms to their employees, but most employers have benefited from the extension.

This article provides an overview of the ACA requirements and offers practical considerations for companies as they continue to implement their ACA compliance program.

Overview of the ACA Employer Mandate and Information Reporting

After a one-year delay, the Employer Mandate officially took effect for large employers on January 1, 2015, with some transition relief for large employers with certain non-calendar-year plans. Currently, "large" employers are defined as those who employ an average of at least 50 full-time equivalent employees on business days in the preceding calendar year; for 2015, the threshold for large employer status was an average of 100 full-time equivalent employees on business days in 2014. For purposes of determining large employer status, companies need to take into account full-time employees in related entities (i.e., controlled group) due to the application of the aggregation rules.

According to the mandate, a large employer can either offer minimum essential coverage to its full-time employees (defined as an employee who is employed an average of at least 30 hours of service per week) and their dependents or face substantial penalties in the form of nondeductible excise taxes:

- If an employer fails to offer minimum essential coverage to substantially all of its full-time employees and just one full-time employee receives a valid premium tax credit, the employer's potential excise tax is $2,000 multiplied by its total number of full-time employees.
- A less substantial – but still significant—excise tax penalty may apply on an employee-by-employee basis if a large employer offers coverage that is not affordable or does not meet minimum value standards and a full-time employee receives a valid premium tax credit.

These penalties, as well as the reporting requirements, apply on a legal entity basis, meaning that if one of two entities with the same parent company falls below the "substantially all" threshold and the other satisfies the requirement to offer coverage to substantially all of its full-time employees, then only the entity that failed to meet the threshold is subject to the Employer Mandate excise tax.

Information reporting

In order to enforce the Employer Mandate (and the Individual Mandate, which went into effect January 1, 2014), employers are also subject to IRS information reporting requirements.

On an annual basis, large employers are required to compile data related to the prior calendar year and furnish an IRS Form 1095-C to each full-time employee and file IRS Form 1094-C (with all applicable Forms 1095-C) to the IRS for each legal entity within its controlled group which employs any full-time employees.

Employers that fail to furnish and file these forms accurately or timely could be subject to additional penalties. Importantly, Notice 2016-4 states that further extensions of these furnishing and filing deadlines are not available for calendar year 2015 returns furnished and filed in 2016.

Critical considerations

The ACA has wide-ranging implications on a number of business functions – employee benefits, staffing, data, and technology. It can also have tax and financial implications which in turn can have a meaningful effect on a company's bottom line. Now that the *King v. Burwell* decision validating the premium tax credits in states where the federal government manages the Exchange is behind us, there are a few critical questions all employers should consider today as they finalize their ACA compliance and reporting plans.

1) **What does it take to comply with ACA reporting requirements?**

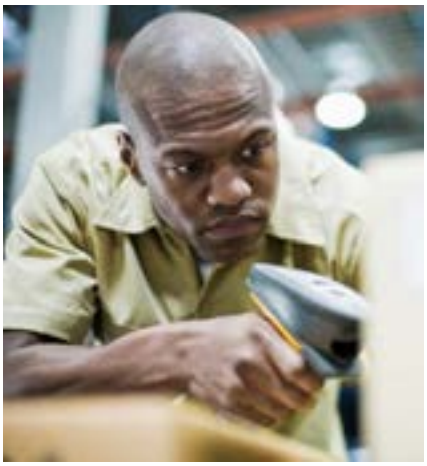
Many employers have told us that they are not worried about the ACA reporting and full-time measurement requirements because they offer very generous benefits or they have few or no employees working less than 30 hours per week. While that fact pattern is certainly advantageous, all large employers are now required to provide informational reporting to their full-time employees and the IRS, and determining full-time status under ACA regulations on a month-by-month basis goes well beyond reviewing scheduled hours.

Although ACA reporting is often compared to Form W-2 reporting, the Form 1095-C provides very different information and in some ways is more complicated than the Form W-2. The Form 1095-C requires more data to produce than is required on a W-2, and is submitted to the IRS, not the Social Security Administration. The form requires employers to indicate the following for each full-time employee on a monthly basis:

- Whether an offer of coverage was made to the employee,
- To whom the coverage was offered,
- The lowest-cost monthly premium for self-only coverage available to the employee, and
- Waiting periods, safe harbors and enrollment data
- Reporting this information requires the selection of IRS-prescribed indicator codes (from a list of 18 different codes) so it is critical to have a system that translates employee payroll and benefits data into the applicable indicator codes. In addition, employers offering self-insured plans have to report month-by-month enrollment information for each covered individual (i.e., the covered employee and dependents), including non-employee enrollees such as COBRA recipients and pre-65 retirees.
- Now is the time to evaluate the technology and the resources available to accurately prepare hundreds or even thousands of Forms 1095-C. As mentioned above, Forms 1094-C and 1095-C are tax forms that will be submitted to the IRS, so it may be beneficial for a representative from the tax department be engaged with Human Resource professionals in reviewing the forms prior to their distribution to employees and their transmittal to the IRS. As with other information reporting requirements, the IRS may levy a penalty which was recently increased to up to $250 *per form* on employers that fail to report timely and/or fail to report accurate information. The IRS may waive the penalty for inaccuracies for calendar year 2015 reporting for employers that timely file these returns making a good faith effort to comply although qualifications for good faith are not specified.

- Lastly, it is critical that employers keep up to date with legislative and regulatory changes and utilize a reporting solution that can adapt to changing reporting requirements. The final 2015 Instructions for Forms 1094-C and 1095-C, released on September 16, 2015, provide additional guidance in a number of areas, including form corrections, multiemployer plans, COBRA coverage, and the 98% Offer Method for reporting. One additional item not to be overlooked is the IRS electronic transmission requirement. Employers filing more than 250 forms must transmit the forms to the IRS electronically via the Affordable Care Act Information Returns ("AIR") system, which utilizes a very complex XML schema. Employers should keep track of AIR developments and requirements to ensure that they can successfully transmit all forms to the IRS by the end of June 2016. Like other IRS e-Services tools, employers or their reporting vendors must complete an e-Services registration and apply for a Transmitter Control Code ("TCC"). A tutorial for the TCC application is available on the IRS website.

2) **Who is an employee?**



The ACA shines a light on two unique groups of workers that have not been offered benefits coverage historically by employers: contractors and contingent workers. These workers 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.

Under the ACA, employers must offer coverage to "substantially all" of their employees. For calendar year 2015, "substantially all" was defined as 70 percent, rising to 95 percent in 2016 and thereafter. Beginning January 1, 2016 (or in some cases, later at the start of the plan year beginning in 2016), employers now have a very small margin of error – just 5 percent – in offering full-time employees coverage, or face significant, possibly material, non-deductible excise tax penalties. With such a small margin of error, it is crucial that employers understand how full-time workers are classified.

The 4980H(a) tax penalty kicks in if 1) the IRS were to deem contingent workers to be employees under the common law standard, 2) the employees worked full-time hours and received a valid premium tax credit, and 3) the number of full-time employees not offered coverage in any one entity was greater than 5 percent of the entity's total employee population. Ensuring 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 contract language used with staffing agencies. These are just a few ways that employers can identify a contingent worker "blind spot."

3) **Who is full-time?**

IRS regulations allow two alternative methods to determine full-time status: 1) a monthly measurement method that requires employers to treat an employee as full-time in any month where that employee works on average 30 or more hours per week; or 2) a look-back method that allows employers to average each employee's hours over a measurement period that can be up to 12 months.

Many employers with large part-time, seasonal, or variable-hour populations utilize the look-back method because it offers them a safe harbor period where no offer of coverage is required (i.e., the look-back measurement period). The challenge is that the look-back method may lock the employee into full-time status for an associated "stability period" (a period of time at least equal in length to the measurement period) even if that employee changes positions or transitions into a part-time schedule after the measurement period is over.

Another issue employers face that impacts full-time determinations is data management. The data required to measure full-time status often resides in many systems: timekeeping, payroll, disability, leaves of absence, FMLA, to name a few. In some cases, data related to contingent workers is simply unavailable. Further,

employers with decentralized HR functions or who have employees working in multiple entities are having difficulty aggregating data from multiple systems at the controlled group level in order to properly determine an employee's full-time status.

Required historical data may also reside in legacy systems. For 2015 reporting, transition relief allowed employers to use a six-month look-back period with a 12-month stability period, which would allow employers to avoid gathering data from 2013. However, employers that do not elect the look-back method transition relief may need to have access to all of this data as far back as 2013 to determine full-time status for the 2015 plan year.

Many of the employers that we have met with in the last few years have or are in the process of migrating onto new Human Resource Information System platforms. For most employers, accessing data from legacy systems requires significant lead time to align appropriate IT resources. In many cases, required data is not easily accessible for future use.

Going forward, employers need to ensure that all data from legacy systems is retained 1) to measure full-time status under the look-back method and 2) so that all IRS inquiries and audits can be properly managed.

4) **What are the potential risk areas?**

Given the complexity of the ACA requirements, companies should review their assumptions, computations and inputs related to their ACA filings to ensure that their risk areas are identified. The Employer Mandate excise tax penalty may be material for many employers who have not finalized a strategy for ACA compliance and reporting. For example, if an entity with 3,000 full-time employees does not offer coverage to substantially all full-time employees, it could face a non-deductible excise tax of up to $6 million if just one full-time employee who was not offered coverage goes to an exchange and receives a valid premium tax credit. Thankfully, this tax penalty is pro-rated based on the number of months in which the employer did not offer coverage to substantially all full-time employees (70% in 2015; 95% in 2016 and thereafter). Thus, tracking compliance with the Employer Mandate requirements on a monthly basis by entity is a key function that employers need to be aware of and have the capabilities to perform.

Many employers have thought about risk areas, but have yet to document them. Some general considerations to evaluate include:

- **Employer mandate** (IRC § 4980H(a)) **compliance** – Is coverage offered to substantially all full-time employees each month and is it documented?
- **Offer of coverage** – Does the employer track when coverage is offered to each employee and when an employee waives coverage?
- **How are full-time employees determined?** Does the definition align with the regulations? Was there an analysis of pay codes to determine which "hours of service" should be included in the 30-hour calculation?
- **Measurement method** – Which method is being used? Does it incorporate rehires and leaves of absence? Has the calculation been performed on a legal entity basis?

- **Flexible technology** – Are systems flexible enough to accommodate changes in legislation?
- **Overtime and scheduling** – Are actual hours worked tracked accurately?
- **Employee education** – What materials are provided to employees about health plan offerings?
- **Contingent workers** – What, if any, protocols are in place for using contractors and staffing agencies? What is the auditable process to ensure the full universe has been captured?
- **Marketplace notices** – Is there a system to track and respond to notices when employees apply for premium tax credits?

5) **Where are we headed?**

The first ACA reporting deadline has now passed and the tax penalties for non-compliance may be significant. Although Notice 2016-4 instructs that some penalties for failure to timely furnish or file Forms 1095-C may be abated for reasonable cause, reasonable cause relief is not automatic. The Notice emphasizes the importance of timely furnishing and filing, even if there are some inaccuracies on the forms. The IRS has also accounted for the extension's potential impact on employees by stating in Notice 2016-4 that "individuals who rely upon other information received from employers about their offers of coverage for purposes of determining eligibility for the premium tax credit when filing their income tax returns need not amend their returns once they receive their Forms 1095-C or any corrected Forms 1095-C." As of the date of this article, the IRS has not announced a similar extension for calendar year 2016 reporting.

When deciding on the right approach to address ACA compliance and reporting going forward , employers must consider the available resources – IT, HR, Payroll, Tax, etc. – and clearly define their responsibilities. A critical success factor is assembling a cross-functional team that can work together to manage the project, make and review decisions informed by lessons learned in 2015, and test and configure data specifications. Internal resources, particularly those from HR and IT departments, will likely have limited capacity during the period leading up to open enrollment. Now is the time for each employer to evaluate and review internal capabilities and processes so that the company can evaluate its existing program and improve its ACA compliance and reporting processes.

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