Avoiding a Taxing Experience

Keep Your Everyday Health Benefits from Becoming a Luxury

Presented By:
Tom Edwards – Senior Vice President, Keenan & Associates
Regina Horton – Legal Counsel, Keenan & Associates
Kathryn Downs – Finance Director, City of Carson

Today's Agenda

- **Final Countdown on Reporting**
  - Deadlines are Almost Here
  - Make a Reasonable, Good Faith Effort
- **It's 95% or Bust for 2016**
  - Penalties Increase Annually
  - Waivers of Coverage
- **Let's Talk About Affordability**
  - Safe Harbors Indexed
  - Cash-in-Lieu: New Guidance
- **What's Going on with the Cadillac Tax?**
  - Will it Just Go Away?
  - Are You Ready?

It's the Final Countdown…

Reporting Deadlines Are Almost Here!

- **Reporting to Individuals/Employees Due:**
  - First reporting delayed to March 31, 2016.
- **Reporting to IRS Due:**
  - First reporting delayed to May 31, 2016 if filing paper forms or June 30, 2016 if filing electronically.
  - If filing 250 or more forms, then ***must*** file electronically.
  - First reporting is based on 2015 calendar year.
- **What if we don't meet these deadlines?**
  - Employers who do not comply with the extended due dates are subject to penalties under IRC sections 6721 and 6722 for failure to timely file and furnish.

What Are the Penalties?

Type of Penalty	Amount per Return	Maximum per Calendar Year
Failure to file/furnish	\$250 (previously \$100)	\$3,000,000 (previously \$1,500,000)
Failure to file/furnish but corrected within 30 days	\$50 (previously \$30)	\$500,000 (previously \$250,000)
Failure to file/furnish but corrected by August 1st	\$100 (previously \$60)	\$1,500,00 (previously \$500,000)
Intentionally failing to file timely and correct returns	\$500 (previously \$250)	No maximum

Make a Reasonable, Good Faith Effort

- **For 2016, the IRS will not impose penalties under sections 6721 and 6722 if employers can show they made good faith efforts to comply.**
  - Applies only to incorrect or incomplete information provided on the return or statement.
  - Does not apply if employers cannot show good faith efforts or fails to timely file a return or statement.
  - However, employers who file late may still get some relief at the discretion of the IRS. Factors the IRS will consider:
    - Were reasonable efforts made to prepare for reporting, such as gathering and transmitting data to a vendor or testing whether information could be electronically transmitted to the IRS.
    - The IRS will also consider the extent to which an employer is taking steps to ensure it will be able to comply next year.

Is It Over Yet?

- **Tracking and reporting will be an ongoing obligation – this is not a one year only requirement.**
  - Start thinking about steps to take over the upcoming months that will make this easier next time around.
  - If you're struggling doing this on your own, consider third party vendors for help with future years.

It's 95% or Bust for 2016

Will You Meet the Threshold?

- **An Applicable Large Employer (ALE) may be subject to a penalty if it does not offer its ACA defined FT employees, and their dependents, minimum essential coverage (MEC) that is affordable and provides minimum value (MV).**
  - **"A" Penalty** – ALE fails to offer MEC to at least 95% (70% for 2015) of its FT employees and their dependents
  - Reduction from 95% to 70% is through the end of the 2015 plan year <u>only</u>.
  - Must meet 95% threshold on the first day of 2016 plan year.

Penalties to Increase Annually

- **Amounts for both the "A" and "B" penalties are indexed to increase each calendar year after 2014.**
  - The IRS issued Notice 2015-87 in December 2015 confirming the "A" penalty increased to $2,080 for 2015 and $2,160 for 2016.
  - The "B" penalty increased to $3,120 for 2015 and $3,240 for 2016.
  - Adjustments for future years will be determined by the IRS at a later date.

Waivers of Coverage

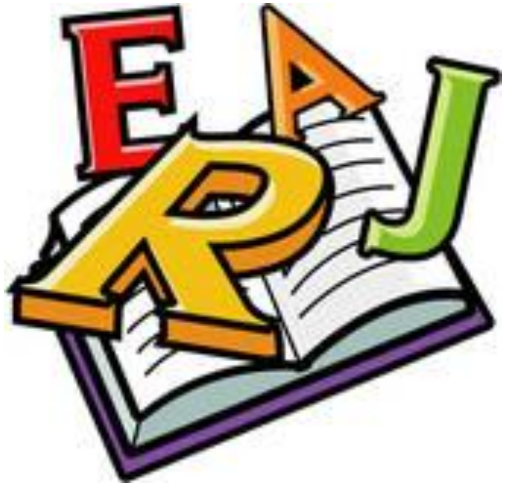
- To be considered an offer of MEC, an employee must be given an effective opportunity to enroll in or decline coverage.
- However, an effective opportunity to decline is not required if the offer of MEC providing MV is offered at either:
  - No cost to the employee, or
  - If the employee's required monthly contribution for the lowest cost self-only coverage does not exceed 9.5 percent of the federal poverty line for a single individual for the calendar year, divided by 12 (i.e., $94.75 per month for 2016).
- If the employee's required contribution is more than $94.75 per month for 2016, then the employees must be able to decline coverage and they must be able to do so for any reason.

Waivers of Coverage

- If a waiver of coverage is conditioned upon proof or certification of other coverage, then the employee cannot decline coverage for any reason.
- As a result, the employer may be treated as though it did not make an offer of MEC to these employees under the Employer Mandate, which could impact whether the employer meets the 95% threshold.
  - Review your waiver of coverage policy to ensure you are in compliance with this part of the Employer Mandate.

Waivers of Coverage

- **Other word of caution – proof of other coverage should not include individual coverage in order to avoid creating an impermissible "Employer Payment Plan."**
  - Avoid using vague language that refers generally to "other coverage" without specifying group health coverage, Medicare, etc. as it could be interpreted to include individual coverage.



Let’s Talk About Affordability

License No. 0451271

Affordability Safe Harbors Indexed

- Affordability under the ACA pops up in three different places – the Employer Mandate, the Individual Mandate and eligibility for premium tax credits or cost-sharing subsidies.
  - Until recently, only the affordability percentage for purposes of the Individual Mandate and eligibility for premium tax credits or cost-sharing subsidies were indexed to increase annually.
  - The percentage for the affordability safe harbors used by employers subject to the Employer Mandate was not indexed.
  - IRS Notice 2015-87 corrects this discrepancy.

Affordability	2015	2016
Employer Mandate Affordability Safe Harbors	9.56%	9.66%
Eligibility for Premium Tax Credits or Cost-sharing Subsidies	9.56%	9.66%
Individual Mandate	8.05%	8.13%

Cash-in-Lieu: New Guidance

- **In Notice 2015-87, the IRS stated they will issue proposed regulations requiring that an amount offered as cash-in-lieu be included in the employee's required monthly contribution for the cost of coverage.**
  - Notice 2015-87 only addresses "unconditional" arrangements (i.e., those not tied to proof of other coverage).
  - The IRS plans to address "conditional" arrangements (i.e., those tied to proof of other coverage) in the forthcoming regulations.
    - At this point, it is unclear how the IRS will treat these types of arrangements for purposes of affordability.

Cash-in-Lieu: New Guidance

- **Example**
  - Assume City of XYZ offers its employees coverage under a group health plan through a §125 cafeteria plan.
  - The employee's required monthly contribution for the lowest cost self-only coverage that provides MV is $100 per month but employees can take $150 as cash-in-lieu of benefits.
  - For purposes of the Employer Mandate "B" penalty and the related reporting on Line 15 of IRS Form 1095-C, the employee's required contribution for the group health coverage is $250 per month.
    - It does not matter whether the employee actually enrolled in the lowest cost self-only coverage that provides MV or took cash-in-lieu or enrolled in a more expensive plan.

Cash-in-Lieu: New Guidance

- **Effective date differs for arrangements adopted on or before December 16, 2015 and those adopted after that date.**
  - Those adopted on or before December 16, 2015 do not need to comply until final regulations are issued.
  - For arrangements adopted after December 16, 2015, the new guidance is effective now.
- **Next steps:**
  - Evaluate the impact of this guidance on the affordability of your lowest cost self-only coverage that provides MV.
  - Consider restructuring the cash-in-lieu arrangement, if necessary, to ensure the lowest cost self-only coverage that provides MV is affordable.
  - Wait for further guidance.

Impact of HRA Contributions

- **IRS Notice 2015-88 clarified when employer contributions to an HRA will reduce an employee's required contribution for purposes of affordability.**
  - Applies only to HRAs integrated with an employer-sponsored group health plan and that employees may use only to pay for premiums or allowable medical expenses.
  - Applies only to amounts made available for the current plan year and to the extent the employer's annual contribution is required under the terms of the arrangement or is otherwise determinable within a reasonable time before the employee must decide whether to enroll in the plan.

Impact of HRA Contributions

- **Example**
  - Assume City of XYZ offers its employees coverage under a group health plan with an integrated HRA.
  - The employee's required monthly contribution for the lowest cost self-only coverage that provides MV is $200 per month. For the current plan year, the employer makes newly available $1,200 under the HRA that employees may use for premiums or medical expenses.
  - For purposes of the Employer Mandate "B" penalty and the related reporting on Line 15 of IRS Form 1095-C, the employee's required contribution for the group health coverage is $100 ($200 - $100) per month because 1/12 of the $1,200 HRA contributions reduces the employee's required monthly contribution.

A Real World Perspective…

What's Going on with the Cadillac Tax?

Do I Still Have to Worry About This?

- **Yes!**
  - The Consolidated Appropriations Act, 2016 that was signed into law on December 18, 2015 delayed the effective date of the "Cadillac" Tax for two years – until 2020.
  - But the Tax was not eliminated or materially changed (although it's now deductible). It's just delayed.
- **Now we don't have to worry about the Tax for another two years! Or, do we?**
  - Most employers and labor breathed a big sigh of relief.
  - Although pressure for immediate change has lessened, the Tax is still looming out there.
  - Waiting to implement a strategy could exacerbate your Tax problem when it finally becomes effective.
  - Don't stop planning!

Legislative Outlook

- Everyone seems to hate this tax – won't it just go away?
- Does the delay until 2020 mean that it will go away?
- Several Congressional bills introduced over the last year to repeal the tax.
- Questions remain: Is there enough support to get any of these bills through Congress? How to replace funding?
- Presidential veto under current Administration. Different result possible under new Administration?
- Alliance to Fight the Forty
  - Private and Public Employers, Unions and Insurers

The Cadillac Tax

Just for Fun

- Imagine it is October 2020.
- The new President and Congress have not further delayed, modified or eliminated the Cadillac Tax.
- You have responsibility for benefits, compensation and payroll and you are planning to retire in two years.
- You have just discovered that your highest cost PPO plan with one-third of your employees enrolled has a projected 2020 excise tax liability of $1,500,000.
- You must now inform your Board (or other business officials) of this $1,500,000 surprise cost that must be paid in the first half of 2021……………

Why Does the Cadillac Tax Exist?

- **Show me the money!!!!!**
  - The ACA is expensive.
- **Helps reduce the apparent cost of the ACA**
- **Helps fund the cost of the ACA**
  - The Cadillac Tax is expected to raise approximately $90 billion over first decade.
  - Assist with slowing the rate of health care cost increases.
  - Create more informed and engaged healthcare consumers.

Why Does the Cadillac Tax Exist?

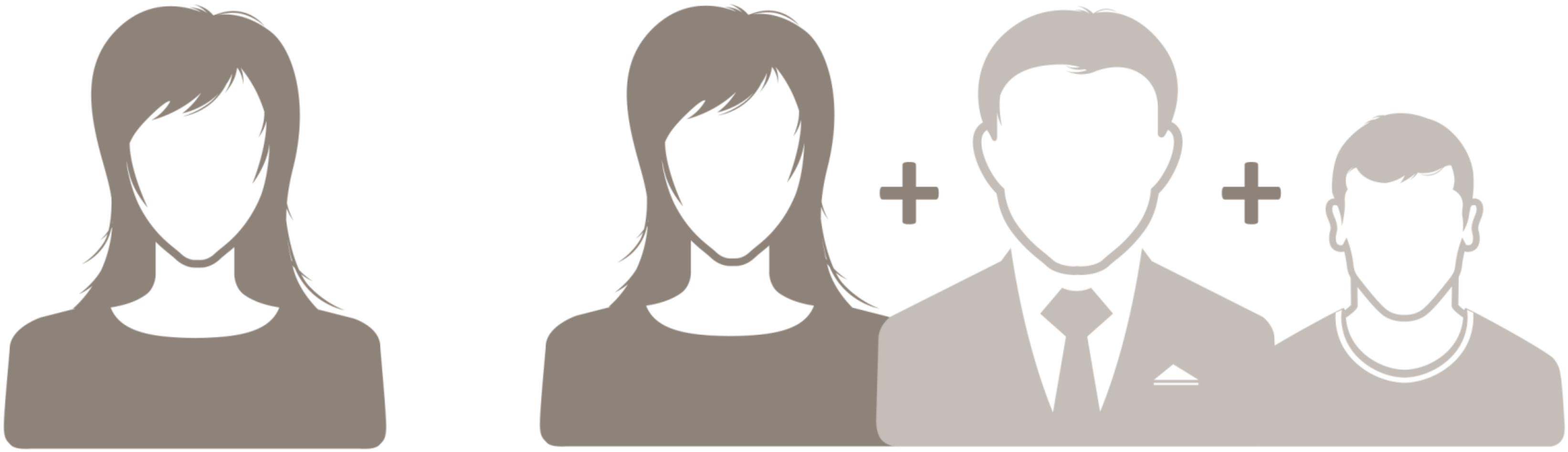
- **Address the perception of unequal tax treatment of employer-sponsored health coverage**
  - Tax-favored treatment “costs” the government approximately $250 billion annually.
  - Perception that highly-compensated employees receive greater tax benefit than non-highly compensated employees.
  - Employer-sponsored benefits receive favorable tax treatment compared to individual coverage.

The Basics – What is It?

- The “Cadillac” Tax is a 40% Excise Tax on calendar year 2020 “high-cost” benefit plans above federal thresholds.
- Only two categories: “self-only” and “other than self-only.”

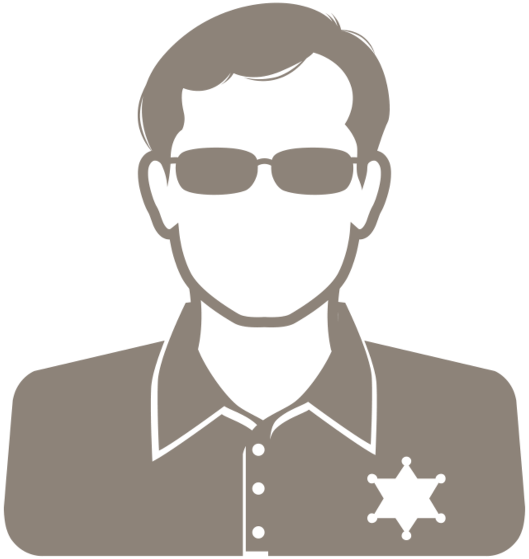
$10,200 for individuals

$27,500 for families



The Basics – What is It?

- Thresholds for pre-65 retirees and high risk employees (police, firefighters, EMTs, etc.) are **$11,850 for individuals and $30,950 for families.**
- Costs include employer/employee contributions toward premium, including medical, Rx, behavioral health, chiropractic, EAP, on-site clinics, employer and employee contributions to FSA contributions, employer HRA contributions, and employer and pre-tax employee contributions toward an HSA.



The Basics – What is It?

- IRS considering approaches for HRA cost determination.
  - Possibly count only amounts made newly available each year, or
  - Average of all HRA contributions.
- President Obama's 2017 budget plan includes provision for using average (rather than individual) FSA contributions for similarly situated employees.
  - Would help simplify some recordkeeping and planning burdens.
- Only governmental guidance is from the original ACA and two IRS Notices.
  - Notice 2015-16 issued in February 2015
  - Notice 2015-52 issued in July 2015

The Basics – What is It?

- Applies to Fully Insured and Self-Funded (ASO) employer-sponsored health plans.
- The Tax calculation is applied to each health plan on a separate basis. Employers may not average all plans to determine the Cadillac Tax liability.

The Basics – What is It?

- The Tax is actually calculated on a <u>monthly</u> basis (using 1/12 of annual thresholds and premium amounts).
- Costs also include pre-tax premiums for specified diseases (e.g., Cancer), Critical Illness and Hospital Indemnity plans.
- The Tax is not applicable to insured stand-alone dental and vision plans. Self-Funded dental and vision benefits are likely to be excluded from the calculation pending future guidance.

The Basics – What is It?

- Cost of coverage determined “under rules similar to” rules determining applicable COBRA coverage. More guidance is expected on premium determination approach.
- The Tax calculation includes all employees and dependents, COBRA, retirees without Medicare, and Medicare-eligible retirees covered under the health plan.

Cadillac Tax Sample Calculations

- **Example 1**

Susan Sample – Self Only Coverage	
Annual PPO Plan Cost	$8,400
Tax Threshold	$10,200
Excise Tax Liability	$0

- **Example 2 – Same Situation, but:**
  - Susan makes an annual FSA contribution: $2,000
  - Pre-tax Critical Illness policy $ 420
  - Total “Premium” = $8,400 + $2,000 + $420 = $10,820
  - Excise Tax = ($10,820 - $10,200) = $620 x 40% = **$ 248**

License No. 0451271

Innovative Solutions. Enduring Principles.

Cadillac Tax Sample Calculations

- **Example 3**

Joe Sample – Employee + Family Coverage	
Annual PPO Plan Cost	$26,400
Tax Threshold	$27,500
Excise Tax Liability	$0

- **Example 4 – Same Situation, but:**
  - Joe makes an annual FSA contribution: $2,500
  - Pre-tax Critical Illness policy $ 420
  - Total “Premium” = $26,400 + $2,500 + $420 = $29,320
  - Excise Tax = ($29,320 - $27,500) = $1,820 x 40% = **$ 728**

Any Adjustments to the Thresholds?

- Thresholds will be adjusted if the cost of the federal employee self-funded Blue Cross/Blue Shield plan increases by more than 55% from 2010 to 2018 (which appears unlikely).
- 2019 threshold will increase by CPI-U, plus 1%. Subsequent increases based on just CPI-U.
- Further adjustments may be made to account for the two-year delay in the Tax implementation.
- Thresholds will also be adjusted in 2020 for age and gender demographics compared to national workforce. This may be a very positive development for public agencies.
  - Consolidated Appropriations Act, 2016 commissions a study to determine the appropriate benchmark for age/gender adjustments.

Who Will be Impacted?

- The Cadillac Tax will have a greater impact on high cost plans, and in particular, collectively bargained plans where salary dollars may have been exchanged for increased benefits or reduced employee benefit contributions.
- Originally, there were no adjustments for geographic cost differences. Northern California employers would have been hit particularly hard.
- President Obama's 2017 budget plan includes a regional adjustment proposal.
- Regional adjustment would be based on the State average for "Gold" benefit plans average.

Proposed Regional Adjustment

- Calculated by taking the weighted average of lowest-cost, self-only Silver plan premiums for each age and county in the state, multiplied by 8/7 to simulate the cost of an actuarially-equivalent Gold plan.
- Threshold for family coverage would be constructed by multiplying the self-only threshold by a ratio reflecting the average relationship between single and family plan premiums.
- Adjustments will only be on a State level; still no difference between different State regions or counties. Northern California will be subject to greater Tax exposure.

License No. 0451271

Innovative Solutions. Enduring Principles.

Keenan & Associates

Who Will be Impacted?

- Kaiser Family Foundation estimates 16% of all employer plans without FSAs would have been impacted in 2018. 26% of plans with FSAs would have been liable for some tax. For large employers, the KFF estimates 46% of employers would have been impacted.
  - The impact on California public agency plans is likely to be much higher.
  - Many of our clients with PPO plans or those in high-cost regions have plans that already exceed the thresholds!

Calculating the Tax

- Tax calculation begins in the 2020 calendar year, regardless of when the employer's Plan Year begins.
- Tax liability for 2020 will be reported in 2021 (exact date not yet established).
- The employer is responsible for calculating each coverage provider's share of any excise tax (if more than one), and the employer must report the tax to the coverage provider(s) and the Department of the Treasury in a manner to be determined in future regulatory guidance.
- **If the employer inaccurately calculates the amount of tax, the employer is subject to a penalty equal to 100% of the tax!**

Who is Liable for the Tax?

- Tax is payable by the coverage provider(s).
- Employer must allocate the tax if there are multiple coverage providers.
- Who is the coverage provider?
  - For insured plan: Health Insurer
  - For HSA: Employer making contributions
  - All other coverage (self-funded plans, HRAs and health FSAs):
    - "Person that administers the plan benefits"
    - No statutory definition, except that "Person that administers the plan benefits" includes the plan sponsor, if plan sponsor administers benefits under the plan.

Who is Liable for the Tax?

IRS Notice 2015-52 raised two possibilities:

Option 1: The person responsible for performing the day-to-day functions that constitute the administration of plan benefits, such as receiving/processing claims, answering inquiries, providing technology platform, etc. The IRS anticipates this person would generally be a third-party administrator (TPA).

Option 2: The "person" that has the ultimate authority or responsibility under the plan with respect to the administration of plan benefits, including eligibility determination, arrangements with service providers, authority to terminate contracts, etc. The IRS anticipates this person would be identifiable based on the terms of the plan documents and would not necessarily be the person who performs the day-to-day routine administrative functions. (This approach would include the plan sponsor if the plan sponsor administers the benefits under the plan).

Who is Liable for the Tax?

- Ultimately, we expect the employer will be liable for the Tax under self-funded arrangements, but the issue is not settled and final regulations may have an impact with regard to public agency JPA vs. employer liability.

Planning to Mitigate Tax Liability

Cadillac Tax Planning

STEP 1: Initial 2016 assessment of Cadillac Tax liability/exposure by benefit plan. Identify benefit plans with cost trajectory causing 2020 tax liability.

STEP 2: Model alternatives (plan design, contribution strategy, benefit portfolio) to mitigate costs 2016 to 2020.

STEP 3: Annual re-assessment in 2017, 2018 and 2019. Need employee-level tax projections for accurate planning, no later than 2019.

Cadillac Tax Planning

STEP 1: Perform Initial 2016 Assessment using Benefit plan level tax projections

- Use total rate (gross premium/total funding/COBRA) for each benefit plan option offered. Adjust rates to calendar year.
- Trend total rate or rate components (medical, Rx, behavioral health, EAP, chiropractic), based on how renewal is structured.
- Generate initial tax projections by benefit plan.
- Identify benefit plans with projected 2020 costs above thresholds.
- Calculate or estimate additional tax liability due to FSA contributions or employer contributions to HSA/HRA accounts.
- Also estimate impact of pre-tax, specified diseases, Critical Illness or Hospital Indemnity plans. These will need to be included in final cost estimates on an individual basis to determine actual liability.

Cadillac Tax Planning

- **Communicate with Labor Now!**
  - Even with the two-year delay, communication is critical.
  - Maintain flexible bargaining agreements.
  - Trade health benefit reduction for increased salary dollars or other benefits?

License No. 0451271

Innovative Solutions. Enduring Principles.

Keenan & Associates

Cadillac Tax Planning

STEP 2: Reduce Benefit Costs

- Consider adjusting benefit portfolio.
- Discuss increasing employee cost sharing for current benefit plans (deductibles, copayments, coinsurance).
- Implement or promote Consumer Directed Health Plans (high deductible options), narrow network models or ACOs.
- Rebalance employee contributions (keeping plans “affordable”) to promote migration to more cost effective plans.
- Discuss replacing early and post-65 retiree plan provisions with more flexible exchange options.
- Enhance wellness and population health management programs and increase incentives.
- Limit (or eliminate) FSA, HSA and HRA contributions.

Cadillac Tax Planning

STEP 2 (continued):

- Reduce number of plan participants
- Adjust rate tier structure to more closely align with tax thresholds.
  - Eliminate composite rate.
  - Collapse family and other non self-only tiered rates into one tier.
  - Review early retiree rates within active plan to eliminate subsidy and reduce tax liability.
  - Can make rate tier changes and maintain employee contributions.
- Consider moving fully insured plans to self-funded model.
  - Reduced ACA Fees
  - Lower Administrative Costs
  - More Rate Setting Flexibility

Cadillac Tax Planning

STEP 3: Multi-Year Planning and other Considerations

- Develop a multi-year strategy. Reassess each year to ease transition.
  - Huge changes on 1/1/2020 may create havoc!
- Develop Reporting Methodology
  - No specific requirements set yet by IRS.
  - IRS suggested Form 720 may be used (currently used for PCORI Fee reporting).
  - Must be able to track all premiums/contributions by individual employee on a monthly basis.
  - May require outside vendors to track and report due to complexity.
- Nondiscrimination testing will be required, which may impact Highly Compensated Individuals (HCI).

Cadillac Tax Planning

STEP 3 (continued):

- Additional Cadillac Tax liability will also impact financial statements (GASB 74 and 75).
- Actuarial assumptions that affect GASB AAL:

Current Cost of Benefits	Trend Rate
Discount Rate	Mortality Rate
Turnover Rate	Age/Service Requirement
Participation Rate	Retirement Rate
Vesting Schedule	Aging Factors
Number of Retirees on Benefits	Plans Available to Retirees

- No single solution to reducing GASB Liability

Immediate Considerations

- Is the Cadillac tax on your employer's radar?
- Have you performed an assessment of how your plans might be affected?
- Do your employees know the Cadillac Tax is on the horizon?
- Develop a multi-year strategy. With 2016 benefits already set, there are really just three years remaining to make changes.
- Begin to develop reporting and accounting methodology.
- Watch Congress for changes.
- Avoid the nightmare scenario!

A Real World Perspective…

Questions?

Thank You!

Please visit our website:

www.keenan.com/hcr

Disclaimer – Keenan & Associates is an insurance brokerage and consulting firm. It is not a law firm or an accounting firm. We do not give legal advice or tax advice and neither this presentation, the answers provided during the Question and Answer period, nor any documents accompanying this presentation constitutes or should be construed as legal or tax advice. You are advised to follow up with your own legal counsel and/or tax advisor to discuss how this information affects you.