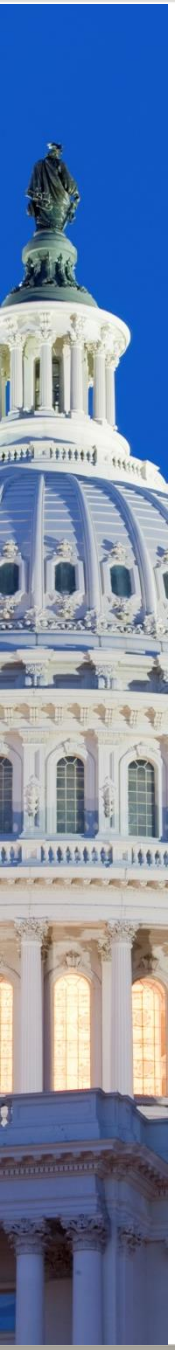
# Employee Benefits Issues

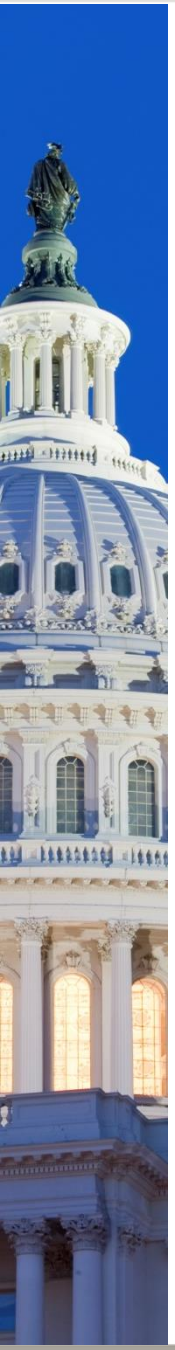
Joel Wood



# Employee Benefits Issues

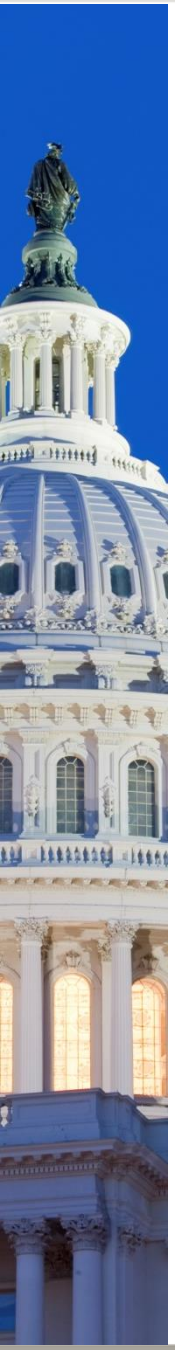
- Elimination of Determination Letter Program for qualified retirement plans

- "Cadillac Plan" Tax under Affordable Care Act



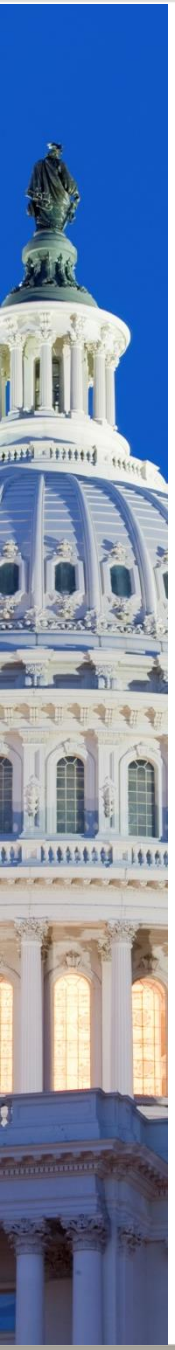
# IRS Determination Letter Program

- IRS Determination Letter ("DL") program developed decades ago, process to provide some certainty as to whether a retirement plan satisfies tax-qualification requirements of Code section 401(a)
- Under Code section 7805(b), plan sponsors are generally entitled to rely on a favorable DL



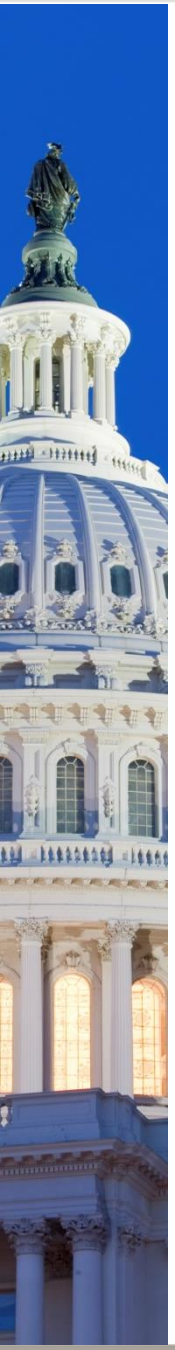
# IRS Determination Letter Program

- Historically, DLs were requested when plan first established, and then periodically thereafter (including plan termination), at discretion of plan sponsor
- In mid-2000s, IRS established the "staggered" five-year DL filing cycle, based on EIN of plan sponsor
  - Five-year cycle also established remedial amendment period for plans



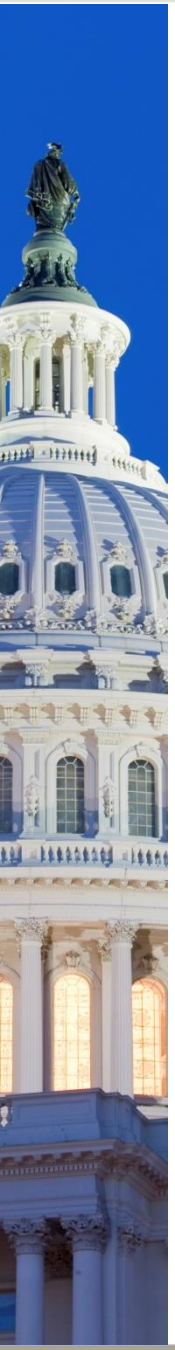
# IRS Announcement 2015-19

- After public discussions about changes to the program, Announcement 2015-19 issued on July 21, 2015
- Per Announcement, effective January 1, 2017, 5-year staggered DL filing cycle will be eliminated
  - However, "Cycle A" plans, will be given until January 31, 2017 to file



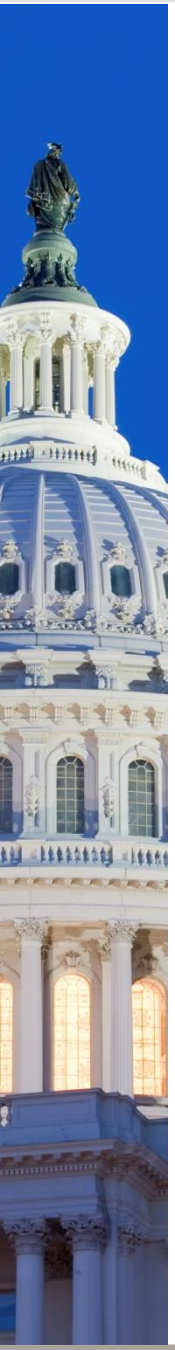
# IRS Announcement 2015-19

- Effective January 1, 2017, individually designed plans can apply for a DL ***only***
  - For new plans (initial qualification)
  - For terminating plans
  - "In certain other limited circumstances that will be determined" by Treasury and IRS
- Effective July 21, 2015, no "off-cycle" DL applications will be accepted (except for new plans and terminating plans)



# Impact of Changes to DL Program

- Era of a recent DL being an effective "short hand" for qualification is closing
- IRS audit risk and expense will increase
  - Plan sponsors may want to have detailed legal review before submission of documents to IRS auditor
- External auditors may require opinions from management/counsel that plans are 401(a) compliant and up to date

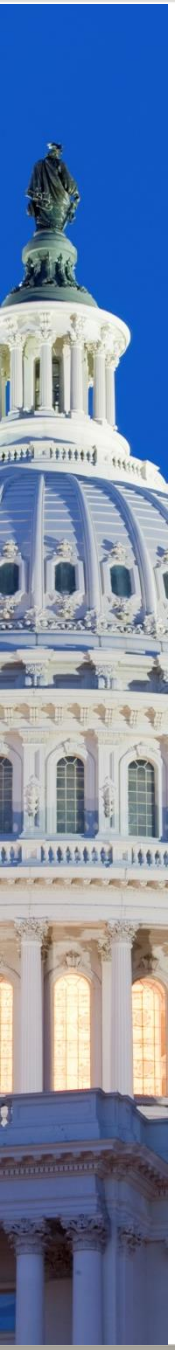


# Impact of Changes to DL Program

- Investment managers who rely on SEC exemptions for "section 401(a) plans" may require management/counsel opinions
- M&A transactions will require more detailed due diligence
  - Relying on recent DL in reps & warranties will no longer be sufficient
- Other changes seem certain in EPCRS and IRS audit procedures

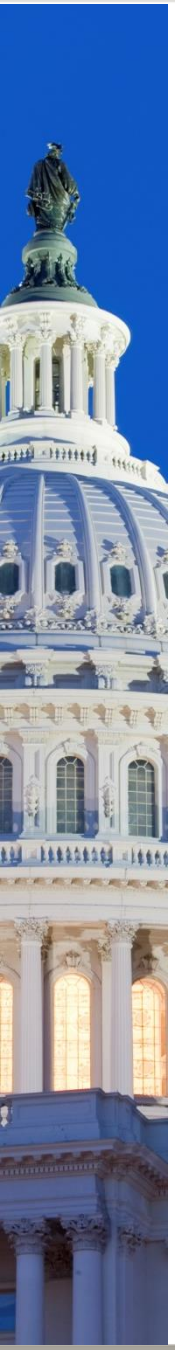
# What is the Cadillac Plan Tax?

- Cadillac Plan Tax is an excise tax under Internal Revenue Code Section 4980I
- 4980I applies, beginning after December 31, 2017, to "applicable employer-sponsored coverage"
- 4980I provides that a 40% excise tax will be imposed on the aggregate value of "applicable employer-sponsored coverage" in excess of statutory thresholds (in 2018, $10,200 for self-only coverage, and $27,500 for "other than self only" coverage (e.g., family coverage, etc.))



# What is the Cadillac Plan Tax?

- The tax applies only to the "excess benefit," i.e., the amount by which the cost of coverage exceeds the statutory threshold
- Tax is calculated on a monthly basis (i.e., only in months in which there is an "excess benefit")
- Cost of "applicable employer-sponsored coverage" (used in calculating "excess benefit") is determined under rules similar to those used to calculate COBRA premiums

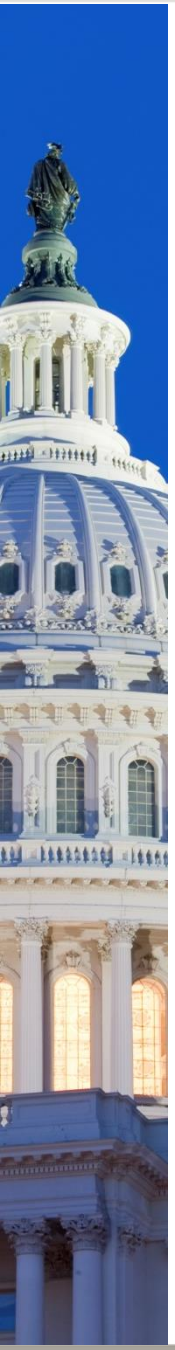


# What is the Cadillac Plan Tax?

- Under 4980I, the ***employer*** is responsible for ***calculating*** the excess benefit and any excise tax . . .
- and the actual ***liability*** for the excise tax rests with
  - the insurer (in the case of insured coverage);
  - the employer (in the case of a Health Savings Account); or
  - the "person that administers the plan benefits" (in the case of other types of coverage)
- The "person that administers the plan benefits" isn't defined, statute says it can be plan sponsor if plan sponsor administers benefits

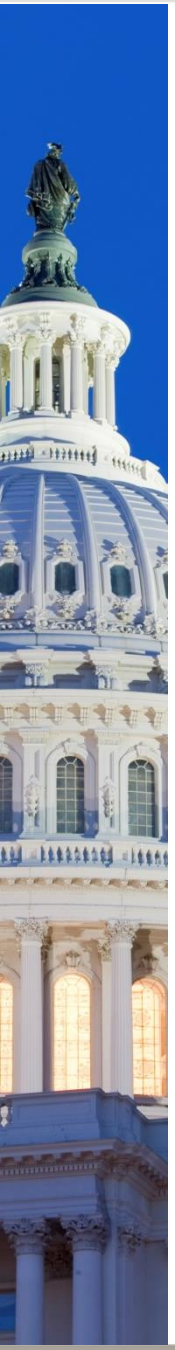
# IRS Notices 2015-16 and 2015-52

- The first substantive guidance on the Cadillac Tax was IRS Notice 2015-16, issued on February 23, 2015
- This was followed by IRS Notice 2015-52, issued on July 30, 2015
- The Notices are "intended to initiate and inform the process of developing regulatory guidance" regarding 4980I
- In both Notices, IRS gives some substantive guidance, while inviting comments in other areas
- Notices indicate that IRS anticipates next issuing proposed regulations



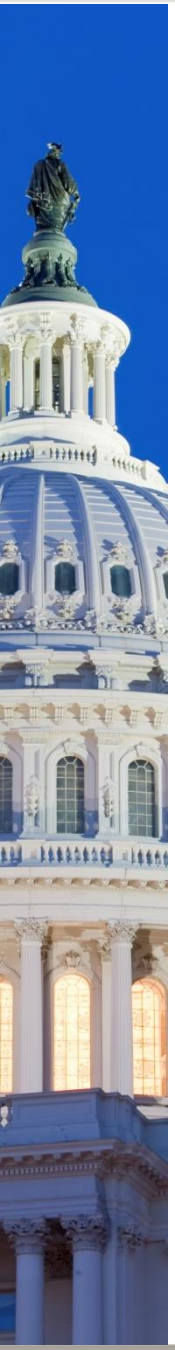
# Definition of Applicable Coverage

- Notice 2015-16 addresses what constitutes "applicable coverage" to which 4980I applies
  - Notice makes clear that "applicable coverage" is determined without regard to who (i.e., employer or employee) pays for the coverage, and that IRS anticipates, in future guidance, making clear that HRAs and executive physical programs ***are*** applicable coverage subject to 4980I
  - Health Savings Accounts, HRAs, certain EAPs and the value of some on-site medical clinics (among other benefits) might be included in the value of "applicable coverage"



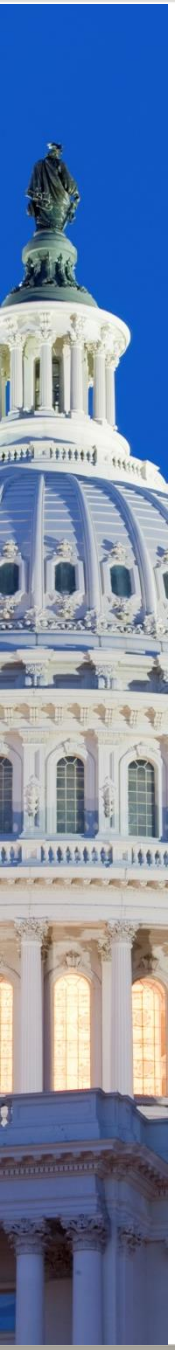
# Determination of Cost of Coverage

- Notice 2015-16 also covers how to determine the cost of "applicable coverage," an important topic given that the 40% excise tax will be determined by reference to such cost (and the extent to which it exceeds statutory thresholds)
- Notice broadly states that rules provided under existing COBRA regulations for determining cost of coverage are likely to be used in this context
  - However, the Notice also raises the possibility of the calculation rules for 4980I deviating in some places from the COBRA rules



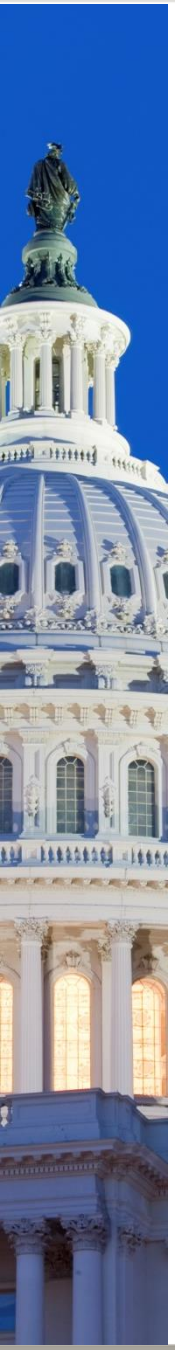
# Liability for 4980I Excise Tax

- Notice 2015-52 states that IRS is considering two alternative approaches to determining identity of "the person that administers the plan benefits":
  - Person responsible for performing day-to-day administrative functions ("this person generally would be a third-party administrator for benefits that are self-insured"); ***or***
  - Person who has ultimate authority or responsibility with respect to plan administration, regardless of whether such authority is routinely exercised
    - IRS anticipates that this person would be identifiable under plan documents and would often ***not*** be person doing day-to-day administration



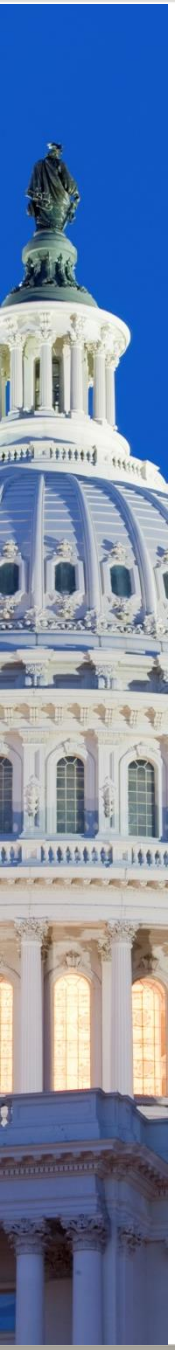
# Payment of Excise Tax

- Although 4980I compliance is measured month-by-month, Notice 2015-52 indicates that IRS anticipates excise-tax payments will be made on an annual basis
- Employers will be required to calculate tax "soon after the end of the taxable year" so that providers can make timely payments
  - This presents issues for self-insured plans with run-out periods, experience-rated plans, etc.



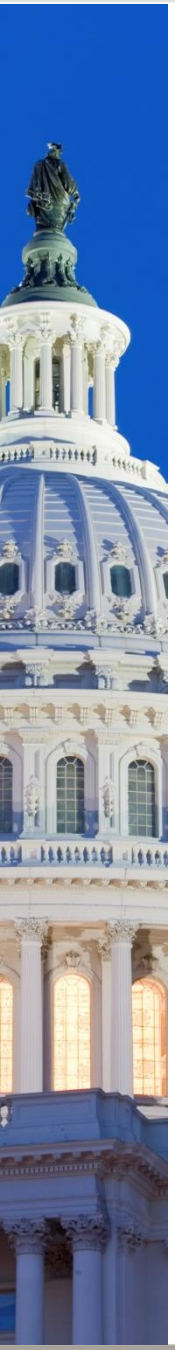
# Exclusion of Excise Tax Amount

- Under statute, excise tax amount is a non-deductible expense
- In Notice 2015-52, IRS anticipates that service providers liable for excise tax will pass through to clients the cost of tax, and may also pass through liability for income tax on "passed through" reimbursement
  - IRS notes that excise-tax reimbursement should be excluded from the cost of applicable coverage, but
  - Believes that some or all of any income-tax reimbursement should be excluded only if separately billed



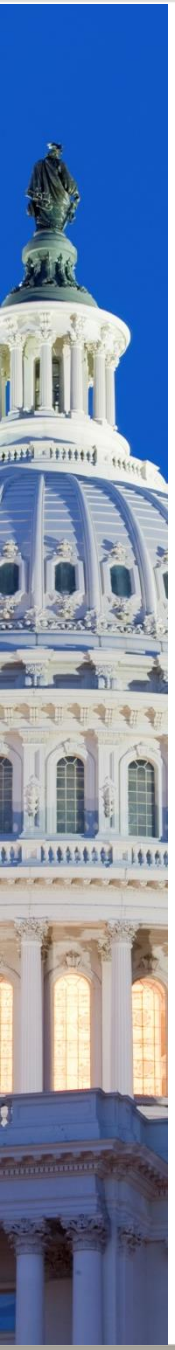
# Other Issues Addressed

- Notice 2015-52 also addresses
  - Allocation of HSA, FSA, HRA and Archer MSA contributions to "applicable coverage"
    - Looking at pro-rata allocation over calendar year, even if full benefit is available immediately
    - Employer flex credits would be credited with amount actually used in excess of deferral (all of deferral counted, but flex may be limited)
  - Age and gender adjustments to baseline per-employee dollar limits
    - Employers would need to compare their age and gender banded groups to similar groups for FEHBP,
    - Dollar limits increase ***only*** if employer total is higher than FEHBP



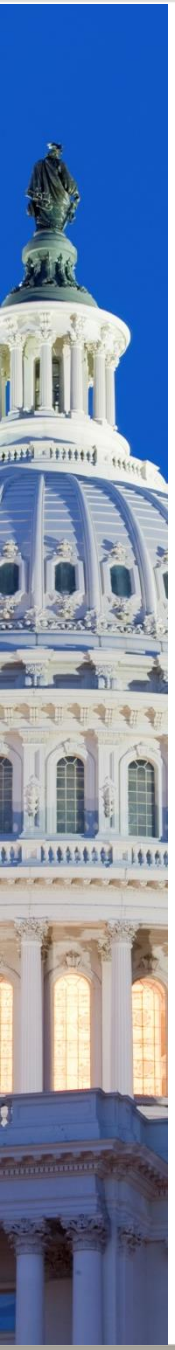
# Open Issues

- The most critical open issue with regard to Cadillac Tax is who is responsible for payment of excise tax in self-funded plans (i.e., does "the person that administers the plan benefits" mean the designated Plan Administrator under ERISA (usually the plan sponsor), or could it mean TPAs, PBMs, etc.?)
  - It was anticipated that Notice 2015-52 would resolve this issue, but IRS has left it open for now



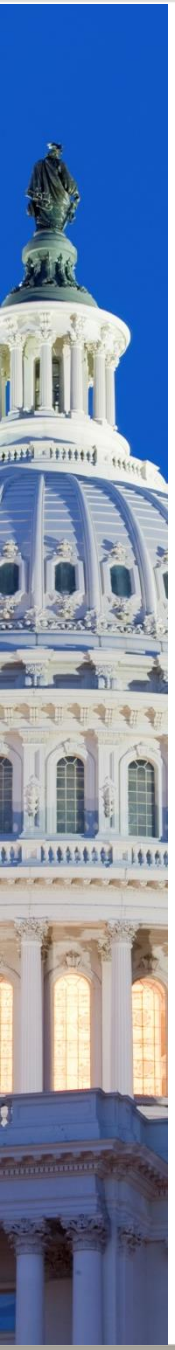
# Open Issues

- Calculation and assessment obligations, under statute, are on employer
  - Calculation looks to be a very complicated administrative task
  - Hard payment due date for excise tax may complicate calculation
  - What challenges are available for service providers? Against employer? IRS? Both?



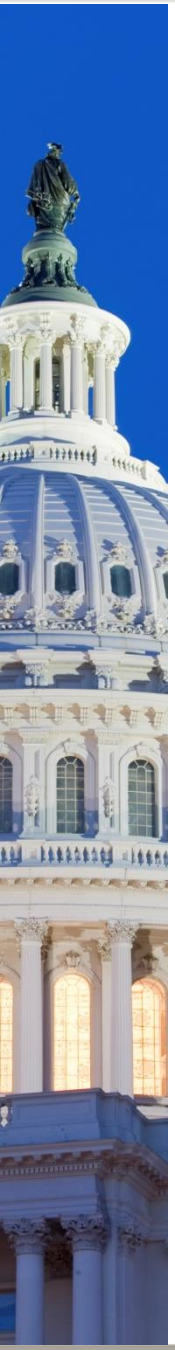
# Action Items

- Employers and insurers should be looking closely at the totality of coverage available to employees
  - Don't assume that, because general group health coverage isn't "excessive," that Cadillac Tax can't be triggered – note that it's the ***aggregate*** cost of all coverage available to employee that is at issue.
  - Plans with HSAs and HRAs will need to remember to add these benefits into the cost of "applicable coverage"
  - Employers should begin planning ***now*** to comply with calculation and assessment responsibilities
- Plan documents and insurance/TPA agreements should be reviewed (to clearly spell out who is responsible for calculation, who is liable for payment, etc.)



# Much Ado About Nothing?

- Bipartisan support in House and Senate to repeal Cadillac Tax
  - But no consensus on how to do so (outright, offset, etc.)
- Obama administration seems destined to veto any repeal attempts
  - How will next administration handle?
  - Can employers avoid any of administrative ramp up?



# Questions

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