Hodgson Russ LLP
ATTORNEYS

EMPLOYEE BENEFITS DEVELOPMENTS DECEMBER 2015

Hodgson Russ Newsletter
December 29, 2015

Agency Guidance

ALERT: IRS Extends ACA Reporting Deadlines. With only a few days remaining in 2015, the IRS provided some welcome relief for employers subject to certain Affordable Care Act reporting requirements. Under IRS Notice 2016-4, the due date for furnishing individuals a copy of IRS Form 1095-C (and IRS Form 1095-B) is extended from February 1, 2016, to March 31, 2016. Similarly, the due dates for filing IRS Form 1094-C (along with copies of the 1095-Cs) with the IRS are extended from February 29, 2016, to May 31, 2016 (if not filing electronically), and from March 31, 2016, to June 30, 2016 (if filing electronically). (IRS Notice 2016-4)

Health Care and the ACA: IRS Formalizes Position on Opt-Out Payments. On December 16, 2015, the IRS, the Department of Health and Human Services, and Department of Labor issued Notice 2015-87, which provides guidance on the application of various provisions of the Affordable Care Act (ACA) to employer-provided health coverage. The guidance can be found here.

Part III of the notice clarifies certain aspects of the employer shared responsibility provisions of Internal Revenue Code §4980H (the so-called "play-or-pay" penalty provisions). Question and answer nine provides much anticipated guidance on the relationship between medical plan opt-out payments and the 9.5 percent affordability threshold under the play-or-pay affordability safe harbors.

The IRS Position on Opt-Out Payments

Before Notice 2015-87 was issued, Internal Revenue Service (IRS) representatives had informally expressed the view that taxable opt-out payments to employees who waive coverage should be added to the employee's premium share for purposes of determining affordability under the ACA's play-or-pay penalty provisions. In light of the absence of any authoritative guidance on the issue, pragmatic practitioners and consultants counseled a wait-and-see approach.

For all practical purposes, the wait is over, although important issues await future guidance. In Notice 2015-87, the IRS formalized the view that the required contribution toward coverage for play-or-pay purposes should include an **unconditional** opt-out payment. The IRS's reasoning is revealed in the following

Attorneys

Peter Bradley

Michael Flanagan

Richard Kaiser

Ryan Murphy

Practices & Industries

Employee Benefits

example:

[I]f an employer offers employees group health coverage through a § 125 cafeteria plan, requiring employees who elect self-only coverage to contribute $200 per month toward the cost of that coverage, and offers an additional $100 per month in taxable wages to each employee who declines the coverage, the offer of $100 in additional compensation has the economic effect of increasing the employee's contribution for the coverage. In this case, the employee contribution for the group health plan effectively would be $300 ($200 + $100) per month, because an employee electing coverage under the health plan must forgo $100 per month in compensation in addition to the $200 per month in salary reduction.

According to the notice, an **unconditional** opt-out payment is "an arrangement providing for a payment conditioned solely on an employee declining coverage under an employer's health plan, and not on an employee satisfying any other **meaningful** requirement related to the provision of health care to employees, such as a requirement to provide proof of coverage provided by a spouse's employer."

Implications of the IRS Position

A simple example illustrates the implications of the position taken by the IRS in Notice 2015-87:

For each calendar month of a given year, full-time employee Smith is required to pay $92 per month for the lowest cost self-only, minimum value medical coverage offered by her employer. Assume this amount is equal to or less than 9.5 percent (as adjusted) of the mainland single federal poverty line for that year. Her employer pays an opt-out cash benefit of $1,200 to employees who waive coverage under the employer's plan. The receipt of the payment is conditioned solely on the employee declining the employer's offer of coverage. Under the IRS guidance, the employee's required contribution for health coverage is $192 per month. This amount consists of the $92 employee premium share plus $100 per month lost opportunity cost (i.e., the $1,200 annual opt-out payment divided by 12).

If the opt-out payment **is not** added to Smith's cost for self-only coverage, and employer coverage includes dependent coverage, Smith's employer could use Code 1A for line 14 of Form 1095-C. Assuming the employer offers coverage to 95 percent or more of its full-time employees for every month of the year, the employer could not be liable for a penalty if Smith were to waive coverage and enroll in subsidized marketplace coverage.

Under Notice 2015-87, the opt-out payment would be added to Smith's cost for self-only coverage, and Smith's employer would then use Code 1E for line 14 of Form 1095-C. Whether the employer would be subject to the so-called "B" penalty if Smith were to waive coverage and enroll in subsidized marketplace coverage would depend on whether the cost of coverage —$192 per month, $2,304 annually in this example—exceeds 9.5 percent (as adjusted) of Smith wages.

Future Guidance

The IRS intends to propose regulations reflecting its opt-out payment position and requesting comments on the treatment of employer offers of opt-out payments. The proposed regulations are expected to address and request comments on the treatment of opt-out payments that are conditioned not only on the employee declining employer-sponsored coverage, but also on satisfaction of additional conditions (such as the employee providing proof of having coverage provided by a spouse's employer or other coverage).

Effective Dates

The effective date of the IRS position depends on when the opt-out arrangement was adopted:

- With respect to arrangements adopted **after** December 16, 2015 ("non-relief-eligible opt-out arrangements"), the IRS anticipates that the regulations will require employers to include an unconditional opt-out payment as part of the employee's required contribution for ACA reporting purposes and will treat such payments as increasing an employee's contribution for play-or-pay penalty purposes.
- For all other arrangements, the IRS anticipates that the regulations will apply only for periods after the issuance of final regulations. Thus, until regulations are issued, employers who maintain "relief-eligible" arrangements are not required to increase the amount of an employee's required contributions for ACA reporting purposes (Form 1095-C), and will not be treated as increasing an employee's contribution for play-or-pay penalty purposes.

The IRS will treat an arrangement as having been adopted **after** December 16, 2015, **unless**:

- The employer offered the opt-out arrangement (or a substantially similar opt-out arrangement) with respect to health coverage provided for a plan year including December 16, 2015;
- A board, committee, or similar body or an authorized officer of the employer specifically adopted the opt-out arrangement **before** December 16, 2015; or
- The employer had provided written communications to employees on or before December 16, 2015, indicating that the opt-out arrangement would be offered to employees at some time in the future.

Employers should carefully determine whether their arrangements qualify as relief-eligible arrangements under the IRS guidance. An employer that intends to continue such an arrangement into the future may want to maintain the arrangement "as is" until future guidance or final regulations are issued. Although the IRS appears to have exempted opt-out payments that are conditioned not only on the employee declining employer-sponsored coverage, but also on satisfaction of additional conditions (such as the employee providing proof of having coverage provided by a spouse's employer or other coverage), conservative employers will want to wait until further guidance is issued before implementing an arrangement that includes an opt-out payment.

Cadillac Tax Delayed Until 2020. On December 18th, President Obama signed the 2016 Consolidated Appropriations Act, delaying the effective date of the excise tax on high-cost, employer-sponsored health coverage, the so called "Cadillac Tax." When effective, the Cadillac Tax will impose a 40 percent excise tax on the aggregate cost of "applicable employer-sponsored coverage" provided to an employee that exceeds a statutory dollar limit ($10,200 for single coverage and $27,500 for family coverage, as adjusted). The aggregate cost of applicable employer sponsored coverage not only includes insured and self-insured group health plans but also health flexible spending accounts, health reimbursement arrangements, health savings accounts, and most wellness programs. In addition to delaying the effective date of the Cadillac Tax, the 2016 Consolidated Appropriations Act provides that when the excise tax becomes effective, it will be deductible as a business expense. Because the Cadillac Tax was originally scheduled to become effective January 1, 2018, many employers (especially those who negotiate multi-year collective bargaining agreements) had already begun to design employee benefit packages that would avoid or minimize exposure to this tax. Although the 2016 Consolidated Appropriations Act does not repeal the

unpopular Cadillac Tax, this two-year delay allows employers additional time to design and implement any considered changes. (H.R. 2029, the Consolidated Appropriations Act, 2016)

Final Regulations Issued Interest Rates Credits for Hybrid Plans Issued. Hybrid retirement plans, the most common of which are cash balance plans, must comply with certain rules on interest crediting on the hypothetical account balance maintained under the plan. The IRS had previously issued proposed regulations setting out permissible interest crediting rules. The IRS has now issued final regulations providing what crediting rates are permissible. Sponsors of hybrid plans should review whether the interest crediting rules contained in their plan satisfies the final regulations. Any changes necessary to bring to the interest crediting rate into compliance with the final regulations must be made in the manner specified by the IRS and be adopted by the first day of the first plan year that begins on or after January 1, 2017. The are certain further delayed compliance dates for collectively bargained plans. (TD 9743 https://www.federalregister.gov/articles/2015/11/16/2015-28915/transitional-amendments-to-satisfy-the-market-rate-of-return-rules-for-hybrid-retirement-plans)

Cases

Court Dismisses Stock Drop Lawsuit Against GM Stock Fund Fiduciary. State Street Bank served as an independent fiduciary of the GM Common Stock Fund, which was a form of ESOP made available for participants to invest their retirement plan accounts in General Motors (GM) stock. In 2008, GM faced severe business problems. Despite those severe business problems and a corresponding drop in the value of GM stock, State Street Bank declined to stop buying GM stock until November 8, 2008, and did not divest the fund of GM stock until March 31, 2009. In June 2009, plan participants sued State Street Bank, alleging that State Street Bank breached its Employee Retirement Income Security Act of 1974 (ERISA) fiduciary duty by failing to manage the fund assets prudently. The case has bounced around the federal court system for a several years, but in 2014, a federal district court granted State Street Bank's motion to dismiss. The plaintiffs appealed that decision, and the Court of Appeals for the Sixth Circuit recently affirmed the district court's grant of summary judgment.

A divided panel of the U.S. Court of Appeals for the Sixth Circuit acknowledged that the Supreme Court's decision in *Fifth Bancorp v. Dudenhoeffer* prevented the court from affirming the district court's grant of the motion to dismiss on presumption-of-prudence grounds. In the majority opinion, the court held that "summary judgment to State Street was appropriate if [the plaintiffs] failed to demonstrate a genuine issue of material fact concerning the methods of State Street's investigation of the merits of investing in GM, or the appropriateness of those methods." The Sixth Circuit's majority also held that a plaintiff claiming that an ESOP's investment in a publicly traded security was imprudent "must show special circumstances to survive a motion to dismiss," but declined to decide whether a fiduciary's "complete failure to investigate a publicly traded investment might constitute a circumstance sufficiently special for a claim of imprudence to survive a motion to dismiss." In this instance, the Sixth Circuit noted that State Street Bank's managers repeatedly met and discussed at length whether to continue the investments in GM stock. Given the prudent process in which State Street Bank was engaged, the Sixth Circuit held that the plaintiffs failed to demonstrate a genuine issue as to whether State Street satisfied its duty of prudence. The Sixth Circuit ultimately held "that State Street's actual processes demonstrated prudence, and the decision of other expert professionals both to invest and not to divest on or near the dates that State Street made those

decisions demonstrated the reasonable nature of those decisions."

This case serves as another reminder that maintaining and following a prudent investment process can be critical in defending against claims for breaches of ERISA fiduciary duties. *Pfeil, et al. v. State Street Bank & Trust Co.* (6th Cir. 2015)

Employee Not Entitled to Refund of FICA Taxes Paid on Benefits Never Received. Under a decision by the U.S. Court of Appeals for the Federal Circuit, a retiree who paid Social Security and Medicare (FICA) taxes on deferred compensation benefits that the retiree never received is not entitled to a refund. Under the "special timing rule" of Internal Revenue Code Section 3121(v), an employee must pay FICA tax on "the amount deferred" under a nonqualified deferred compensation plan as of the later of when the services are performed, or when there is no substantial risk of forfeiture of the right to the benefits.

The employee in this case was a pilot for United Airlines from 1979-2004. On his retirement in 2004, the pilot was eligible to receive retirement benefits for life under a non-qualified deferred compensation plan. Benefits commenced on his retirement, and, in keeping with FICA tax regulations, United withheld more than $4,000 in FICA taxes in 2004 on the present value of his entire benefit. Although the employee was entitled to benefits for life under the plan, United had commenced bankruptcy proceedings in 2002, and its obligation to pay benefits under the plan was later discharged as part of those proceedings. Accordingly, United ceased paying benefits to the employee in 2010.

Following the termination of his benefits, the employee and his wife filed an administrative claim for a refund of more than $3,000 in FICA taxes they had paid on compensation they will never receive. That claim was denied, and the couple filed for a refund in the U.S. Court of Federal Claims. The trial court also denied the claim, upholding the validity of regulations under which the benefits in a "nonaccount balance" plan, such as the plan in question, are taxed at their "present value," and under which there can be no discount for the risk that some or all of the payments will not actually be made. On appeal, the employee and his wife argued that the regulations are invalid or inapplicable in their situation because United was in bankruptcy proceedings when the present value of the benefit was calculated. The court noted that the statute governing timing of the FICA tax contains no definition of the amount that must be included in income, nor does it reference any way to calculate the amount or to determine its present value. After considering the legislative history surrounding enactment of the statue, the appeals court concluded that there is no evidence of "an unambiguous congressional intent that the 'present value' calculation must consider an employer's financial status." As a result, the court upheld the validity of the regulations imposing FICA tax liability on the full value of the employee's benefit at the time of the employee's retirement, without regard to the employer's financial condition. *Balestra, Jr. v. U.S.* (2015, CA Fed Cir)