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Frequently Recurring Questions Regarding the Impact of the Affordable Care Act on Employers: Part II

Since the passage of the Affordable Care Act ("ACA"), many of the questions we have received from our clients focus on tricky issues that arise repeatedly with employers both large and small. To help employers navigate the often rocky regulatory terrain of federal health care reform, we thought it would be useful to draft a series of Alerts containing some of the most common questions we have received and our answers to them. This Alert is the second in that series.

Permissibility of Offering Employees a Health FSA Without a Major Medical Plan

Q-1: Can an employer offer its active employees a Health Flexible Spending Account ("Health FSA") without also offering them a major medical plan?

A-1: In general, no. Unless a Health FSA is limited to reimbursing *only* dental and/or vision expenses (commonly referred to as a "Limited Purpose Health FSA"), an employer *cannot* maintain a stand-alone Health FSA.

The ACA imposes an array of "market reforms" (e.g., prohibition on annual limits, preventive services must be provided without cost sharing, etc.) on most group health plans, including Health FSAs, unless the Health FSA or other group health plan qualifies for an exception.

There is an exception for group health plans that provide only "excepted benefits," the most common of which are dental plans and vision plans. Health FSAs can fit within this exception, but *only if the Health FSA is offered by the employer in conjunction with a major medical plan* (among other requirements).

If a Health FSA is not deemed to be an "excepted benefit," then it is subject to all of the market reforms under the ACA. But, by its very nature, a Health FSA cannot comply with these market reforms. A Health FSA, for example, by law, must have an annual dollar limit on the expenses that can be reimbursed. That limit cannot exceed $2,550, which is inconsistent with the ACA prohibition on annual limits.

As a result, an employer maintaining a Health FSA without a corresponding major medical plan would be subject to excise taxes under the Internal Revenue Code of $100 per day (or $36,500 per year) for every affected employee in the employer's workforce.

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One other important point to bear in mind: the eligibility conditions for participation in the employer's Health FSA and medical plan should generally be the same. The concern is having an employee who is eligible for the Health FSA but not the medical plan. Even if that situation occurs for only a brief period of time (e.g., the medical plan has a longer waiting period than the Health FSA), the Health FSA may lose its status as an "excepted benefit," which could trigger the parade of horribles described above.

Permissibility of Offering Employees an HRA Without a Major Medical Plan

Q-2: Can an employer offer its active employees a Health Reimbursement Arrangement ("HRA") without also offering them a major medical plan?

A-2: The answer is similar to the response to the Health FSA question in Q-1 above. Unless the HRA is restricted to reimbursing *only* dental and/or vision expenses (commonly referred to as a "Limited Purpose HRA"), an employer cannot offer an HRA *unless* the HRA is "*integrated*" with a group health plan providing major medical coverage.

The integration requirements are somewhat complex. One of the key elements, though, is that the HRA participant must *actually be enrolled* in the medical group health plan that is considered to be integrated with the HRA. Although it usually will be the case, the plan that the HRA is integrated with does not necessarily have to be a group health plan sponsored by the employer making the contributions to the HRA. The plan that the HRA is integrated with could, for example, be sponsored by some other employer (e.g., the employee's spouse's employer), so long as the other employer's group health plan satisfies all of the market reform requirements under PPACA.

If the group health plan with which the HRA is integrated provides "minimum value," (as virtually all of our clients' plans do), then the HRA may reimburse any medical expenses not covered by the group health plan that are otherwise deductible under the Internal Revenue Code. (Note: "minimum value" is just an actuarial concept essentially meaning that the plan has to be designed so that it will pay at least 60% of the aggregate claims that covered individuals are expected to incur on an annual basis.) If, on the other hand, the group health plan with which the HRA is integrated does *not* provide "minimum value," the employer can still offer an HRA, but the expenses that may be reimbursed under that HRA are much more limited.

The bottom line, though, is that if the HRA is not properly "integrated" with another medical group health plan, then the employer would be subject to excise taxes under the Internal Revenue Code of $100 per day ($36,500 per year) for every affected employee.

Permissibility of Reducing Employees' Hours Below the 30 Hours/Weeks Threshold

Q-3: If an employer cuts the hours of its employees so that they are no longer regularly scheduled to work at least 30 hours per week (and thus the employer is no longer subject to any penalties for failing to offer them affordable health care coverage), is the employer potentially subject to any other liability?

A-3: This is an unsettled area and is currently the subject of litigation. If an employer reduces the hours of its employees for *bona fide* business reasons that are not motivated by the desire to save on health care costs, it seems unlikely that the employer would be subject to liability. The problem is that there is a provision in ERISA that prohibits employers from taking certain adverse employment actions against an employee *for the purpose of interfering* with the employee's attainment of any right to which he/she may become entitled under the employer's group health plan. The exact scope of this prohibition is subject to debate and, in fact, is now being litigated in federal court in New York.

What we can say for sure is that employers need to tread carefully for now in this area. Moreover, while it might be tempting for certain employers who are not the biggest fans of the ACA to trumpet the steps they are taking to minimize their costs under the law, prudence and self-censorship are the far better courses of action. Employers obviously need to take whatever steps are necessary to ensure the continuity of their business, but this is one of those areas where – at least for now – anything an employer says could come back to haunt it.

IRS Health Care Coverage Reporting Requirements

Q-4: If a business is using a staffing agency to procure part of its workforce, and that staffing agency is offering health care coverage to those workers – even though the workers may be properly treated as the common law employees of the business (often referred to as the staffing agency's "client employer") – which entity is responsible for completing and filing the new IRS health care coverage reporting forms in connection with those workers?

A-4: The answer depends, in our view, on whether the arrangement between the client employer and the staffing agency satisfies the special "safe harbor" that is provided under the preamble to the final "employer shared responsibility" regulations.

If – and only if – the client employer satisfies all the requirements of the special "safe harbor" under the final "shared responsibility" regulations, the health care coverage that is offered to workers by the staffing agency is *deemed to have been offered by the client employer*. As a result, if the requirements of the "safe harbor" are satisfied, we think the forms should likely be completed by the *staffing agency*. We say "likely" because the IRS has not yet addressed this particular question.

The reason we suggest that the staffing agency file the IRS forms is based largely on practical reasons. If the health care coverage is being offered by the staffing agency, the client employer typically won't even know when exactly workers are offered coverage, which workers are enrolled in the coverage, and/or how much the workers are paying for the coverage. Only the staffing agency will possess such information.

Nevertheless, coordination between the staffing agency and the client employer will be essential so that the filing obligation doesn't fall through the cracks. If the forms don't get filed with the IRS and transmitted to employees, the client employer will probably be on the hook.

We acknowledge that it is the *common law employer* that is responsible for offering affordable health care coverage to all of its full-time employees under the "shared responsibility" regulations. In the context of personnel obtained from a staffing agency, the common law employer will often (although not always) be the client employer – rather than the staffing agency itself. But requiring the client employer to complete the IRS health care coverage reporting forms is simply not feasible. Given that the IRS developed a regulatory "safe harbor" under which health care coverage offered by the staffing firm is treated as having been offered by the client employer, it's hard to see the IRS complaining. Indeed, the fiction only works if it is "carried all the way through," i.e., both in the offer of coverage and in the reporting of the same.

The fact that the IRS is utilizing a "good faith" standard when evaluating the 1094/1095 forms that will be filed in connection with the 2015 calendar year should provide additional comfort to employers. Now is a good time, however, for employers relying on staffing agencies to procure part of their workforce to review their administrative services agreements with those staffing agencies to make sure the reporting issue (and, hopefully, indemnification language) is adequately addressed. Indeed, if the regulatory "safe harbor" is not satisfied, then it is clear that the client employer will be responsible for the filing obligation as to any employees of the staffing agency that are considered to be its common law employees.

Q-5: How are most employers planning on handling the new IRS health care coverage reporting requirements, which will have to be filed with the IRS for the first time in the first quarter of 2016?

A-5: As you might imagine, the answer varies widely. Some employers appear to be aggressively getting up to speed on the filing requirements and have either contracted with a payroll provider to handle the reporting on their behalf or – incredibly enough! – are actually programming their own computers to deal with this obligation. Other employers have been much slower out of the gate and, candidly, that gives us some serious pause.

It appears that some payroll providers will be preparing and filing the new health care coverage reporting forms with the IRS for their clients. How well this works remains to be seen. Some of our clients' payroll providers seem to be well-versed in the reporting and coding requirements, as well as the rules of the "shared responsibility" regulations' Look-Back Measurement Method. Others, well, not so much.

More problematically, we are hearing that a number of national payroll platform providers have announced that they will not let any additional employers use their platform modules to comply with the new reporting requirements (or will be jacking up the price if employers don't sign up by a date in the very near future). Apparently, they are saying that they are already at capacity and that their platforms can't handle the additional burden.

One final point to bear in mind: if an employer is handling the filing requirements on its own, and the employer is sufficiently large so that it is obligated to file those forms with the IRS electronically (a requirement triggered if the employer must file at least 250 forms), then the employer first must obtain a Transmitter Control Code ("TCC"). Applying for this TCC can take time, and the application is extremely complicated. So don't put this requirement off until the last minute, and don't schedule any vacation time in the first quarter of 2016.

We will be summarizing the IRS's recent changes to the health care coverage reporting requirements at our Employment Law & Employee Benefits Seminar in early November. In addition, for those who did not have the opportunity to attend our workshops on the new health care reporting requirements earlier this year, we will be repeating the workshop in early December with all the latest updates and guidance. Stay tuned for details.

The questions (and especially the answers) in this Alert are necessarily abbreviated due to space limitations and a desire to avoid readers dozing off while reading them. As you can see, though, the legal issues raised in these questions are extremely complex, and the penalties for missteps can be severe. If you have any questions regarding health care reform compliance for employers, please feel free to call Eric Namee, Steven Smith, or Brad Schlozman at (316) 267-2000.

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