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BENEFITS REPORT

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Be Prepared to Respond to IRS Employer Shared Responsibility Payment Assessments

ELIZABETH LOH

Although it is the holiday season and people's thoughts have turned to vacation with family, eggnog, and gift giving — employers have something slightly less festive to contemplate. The Internal Revenue Service (IRS) has started to send out letters to employers regarding potential Employer Shared Responsibility Payments (ESRP) (one of two types of penalties for failure to satisfy certain coverage rules) relating back to the 2015 plan year. This article describes the actions an employer should take if it receives a proposed ESRP assessment from the IRS.

What are the penalties at stake? Under the Internal Revenue Code (the "Code") Section 4980H rules, an Applicable Large Employer (ALE)[1] may be subject to an ESRP in two ways:

- **The A penalty.** If an ALE does not offer minimum essential coverage to "substantially all" (at least 70% in 2015 and 95% in years after 2015) of its full-time employees (and their dependents), and at least one of its full-time employees receives a premium tax credit on the Health

IN THIS ISSUE...

Trucker ✦ Huss is pleased to announce...

Elizabeth Loh has been appointed Shareholder of the Firm effective January 1, 2018.

Congratulations to Liz!

Insurance Marketplace (the "Exchange"),[2] the ALE will owe an annualized ESRP equal to the number of full-time employees the ALE employed for the calendar year (minus up to 30 employees), multiplied by $2000 (as adjusted each year). Depending on the size of the ALE, this penalty could be substantial, so it is often referred to as the "sledgehammer penalty."

- **The B penalty.** Even if an ALE offers coverage to substantially all of its full-time employees and their dependents, it may still have exposure to the "B" penalty, often called the "tack hammer penalty." If an ALE offers coverage to substantially all of its full-time employees and their dependents, but has one or more full-time employee who receives a premium tax credit on the Exchange, the ALE may face a B penalty payment. Generally, the amount of the payment for the impacted month equals the number of full-time employees who receive a premium tax credit for that month multiplied by 1/12 of $3,000 (as adjusted). An example of how this might occur is if the ALE offered coverage to 95% of its full-time employees, but one of the 5% who did not receive an offer of coverage went out to the Exchange and qualified for a premium tax credit.

Note: The 2015 adjusted penalty amounts under the A penalty and B penalty are $2,080 and $3,120, respectively.

Certain transition relief is available for 2015. Understanding that the ESRP rules generally were first effective in 2015 and were a source of considerable confusion for employers, the IRS provided various forms of "transition relief" to employers for the 2015 year. Examples of this transition relief include, but are not limited to:

- If an employer had fewer than 100 full-time employees, including full-time equivalent employees, it was not assessed an ESRP for 2015. For all other years after 2015, an employer is considered an ALE subject to the ESRP rules if it has 50 or more full-time employees (including full-time equivalent employees).
- Generally, an ALE will owe the A penalty if it does not offer coverage to at least 95% of its full-time employees and their dependents. However, in 2015, an ALE could avoid the A penalty by offering coverage to at least 70% of its full-time employees and their dependents (a significantly relaxed standard).
- If an ALE is subject to the A penalty, the annual payment is generally $2,000 for each full-time employee — adjusted for inflation — after excluding the first 30 full-time employees from the calculation. For 2015, if an ALE with 100 or more full-time employees (including full-time equivalent employees), is subject to an ESRP, the payment will be calculated by reducing the ALE's full-time employees by 80, rather than 30.

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T. Katuri Kaye becomes a Director of the Firm on January 1, 2018.

Congratulations to Katuri!

Given the various forms of transition relief for 2015 (e.g., the 70% standard), it is our guess that a majority of the proposed assessments from the IRS relating to the 2015 plan year will relate to the B penalty and not the A penalty.

How will an employer know if it is subject to IRS penalties? An ALE will first receive notice that it is potentially subject to an ESRP when it receives a Letter 226J from the IRS. This Letter 226J will describe whether the IRS believes the employer owes the A penalty or the B penalty. The letter will also include various attachments that are described further below (i.e., the Employee Premium Tax Credit Listing, an ESRP Summary Table with accompanying explanation, and an ESRP Response Form).

What can an employer do upon receiving an assessment? Upon receiving the Letter 226J, the ALE should take the following steps:

- Read through the Letter 226J and its accompanying attachments carefully. The letter will include an "Employee Premium Tax Credit Listing" which lists the employees (by name) for whom the ALE may have ESRP exposure (i.e., those employees who received a premium tax credit while no safe harbor or other relief from the ESRP was available to the ALE). This Listing also includes the indicator codes that the ALE reported on lines 14 and 16 of each assessable full-time employee's Form 1095-C (i.e., the codes describing whether an offer of coverage was made, and whether any safe-harbor or other relief was available from the ESRP).

  In addition to the Employee Premium Tax Credit Listing, the Letter 226J also includes an ESRP Summary Table where the IRS describes the monthly ESRP amount that the IRS has proposed for the ALE. This Summary Table describes how the IRS calculated the proposed monthly ESRP amounts. When calculating the proposed assessment, the IRS uses such information as the data reported by the ALE on its Form 1094-C, Part III Columns (a) and (b). These columns report whether the ALE offered coverage to substantially all of its full-time employees (i.e., 95% (70% in 2015)), and the ALE's monthly full-time employee count.

  Note, the IRS has issued a helpful guide titled "Understanding your Letter 226J" that an ALE may use when determining how to respond to the letter. The IRS also has issued FAQs (55–58) describing how to pay the ESRP.

- Act immediately. The ALE should educate its workforce that upon receiving a Letter 226J, they will need to forward it to the appropriate individuals (e.g., the ALE's reporting vendor, legal counsel, etc.) for analysis. Prompt action is necessary — the IRS has only provided a 30-day window to respond to the letter.

- Upon receiving a Letter 226J, the ALE will need to quickly determine whether it will be able to meet the 30-day deadline to respond to the IRS. The ALE may request more time to respond by calling the

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Jopseph C. Faucher becomes a Director of the Firm on January 1, 2018.

Congratulations to Joe!

IRS using the telephone number listed on the ESRP Response Form.

- Review the Letter 226J to determine whether the information is accurate. The ALE should review the information reported on the letter and the accompanying attachments and compare them to such information as the ALE's enrollment and payroll records, as well as its copies of the Forms 1094-C and 1095-C that were filed with the IRS.
- If the ALE agrees with the IRS's proposed penalty, it will need to complete, sign and date the enclosed ESRP Response Form (i.e., the Form 14764), and return the Form to the IRS by the date listed on the first page of the Letter 226J. The ALE also will need to make payment by check or through the electronic federal tax payment system.
- If an ALE received a Letter 226J from the IRS, it should not automatically assume that it owes an ESRP. The IRS determination regarding whether an ALE owes an ESRP is based on the information reported by the ALE on its Forms 1094-C and 1095-C. 2015 was the first year that employers were required to complete ACA reporting, and there was considerable confusion (on the part of ALEs as well as the IRS) during this first year of reporting.[3]
  - The ALE should critically analyze the Letter 226J and attachments to determine whether it agrees with the information reported by the IRS in these documents. For example, does the ALE agree with the full-time employee counts listed in the ESRP Summary Table? Has it verified that the proper "allocated reduction of full-time employee count" for purposes of calculating the A penalty was used by the IRS (i.e., for 2015 — an 80 full-time employee reduction instead of 30)? Has the ALE confirmed that the employees listed in the Employee Premium Tax Credit Listing document were in fact full-time employees (and not part-time employees)? Are the employees listed by the IRS actually employees of the ALE? For each employee listed in the Employee Premium Tax Credit Listing, has the ALE confirmed that the employee(s) was truly not offered coverage, and that no safe-harbor or other relief was available from the ESRP?
  - If an ALE disagrees with the information reported in the Letter 226J, it will need to complete an ESRP Response Form (Form 14764) stating that it disagrees with part or all of the proposed ESRP assessment. Further, the ALE will need to include a signed statement explaining why it disagrees with all or part of the proposed assessment. The ALE should include backup documentation supporting its statement (e.g., enrollment materials showing that an offer of coverage was made to the impacted full-time employee, etc.).

- If in the process of reviewing the Letter 226J, the ALE realizes that the information the ALE reported on its Form 1094-C and/or 1095-C was inaccurate, the ALE's response to the IRS should include a statement (and updated Employee PTC Listing) describing any changes it wants to make to the information reported on its Forms 1094-C (the primary form the IRS uses to calculate the A penalty) and/or Forms 1095-C (the primary form the IRS uses to calculate the B penalty). Note: The accompanying instructions to Letter 226J state that the ALE should not file corrected Forms 1094-C or 1095-C to report the requested changes.

Further appeal rights available. Upon receiving the ALE's ESRP Response Form, the IRS will respond by providing the employer with a Letter 227. The Letter 227 will acknowledge the ALE's response and describe further actions the ALE may need to take. If after receiving the Letter 227, the employer still disagrees with the IRS proposed penalty, it will have the opportunity to have a pre-assessment conference with the IRS Office of Appeals.

If after the ALE has taken all of these steps, and the IRS still determines that the ALE is subject to an ESRP, it will issue a notice and demand for payment. Note: An ESRP is not deductible by the ALE.

Conclusion. Given the quick deadline to respond to a proposed ESRP, an employer should make sure that it has ready access to the Forms 1094-C and 1095-C that were filed in 2015, as well to its applicable payroll and enrollment records. It is important that the employer proactively prepare. The employer cannot afford to ignore an IRS Letter 226J. The IRS has clarified that if the ALE does not respond within the 30-day deadline, the IRS will send a "Notice and Demand" for the penalty payment, and the employer could be subject to accrued interest until the employer pays the total penalty payment owed.

Also, as employers enter into another Form 1094-C/1095-C reporting season, it is more clear than ever that accurate Affordable Care Act reporting is critical. The IRS has confirmed that it is determining penalty assessments based on the information that the ALE reported on its IRS Forms 1094-C and 1095-C. An ALE should work to ensure that the information it is reporting is accurate (e.g., full-time employee counts are accurate, offers of coverage are appropriately reported, as well as safe-harbor relief, etc.), and that it is retaining all of the documents necessary to respond to the IRS if the ALE receives a proposed ESRP assessment.

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[1] If an employer is part of an aggregated ALE group (i.e., the same Code section 414 control group), liability under the Code Section 4980H rules applies separately for each ALE member in the aggregated ALE group. Note: Each employer that is a member of an aggregated ALE group is referred to as an ALE member.

[2] An employee may be eligible for a premium tax credit (i.e., a subsidy) if he or she declines the ALE offer of coverage and the ALE coverage offered was not affordable or failed to meet the minimum value standard.

[3] The Treasury Inspector General for Tax Administration published an audit report titled "Assessment of Efforts to Implement the Employer Shared Responsibility Provision" on April 7, 2017. This audit report found that the IRS did not sufficiently test its error code programming for processing Forms 1094-C and 1095-C for 2015 reporting. For example, error codes sometimes were erroneously generated when no error condition existed.

Common Issues Discovered During Retirement Plan Audits: A Discussion with Diane Wasser

CALLAN G. CARTER

I talked with Diane Wasser of EisnerAmper LLP, a national certified public accounting firm with a practice group specializing in the audit of retirement plans, about common issues that Diane and her team discover during their audits of retirement plans. Diane is the Partner-in-Charge of the firm's Pension Services Group. She has more than 25 years of experience providing employee benefit plan audit and consulting services to publicly and privately owned entities across the United States, including those registered on the NYSE. Below is an excerpt of our conversation.

Callan: What are the three most common plan qualification errors you find during your plan audits?

Diane: The most common operational defect we find when performing plan audits is that employers use incorrect compensation when calculating employee and employer contributions to the plan. Each plan document defines compensation in a certain way, setting forth which types of compensation are included or excluded from the plan's definition of "compensation." Unfortunately, this definition is often overlooked in the daily operation of the plan and the employer's payroll. It is also common to see this type of error when an employer adds a new type of compensation and does not consider the impact on the calculation of the employee deferrals and employer contribution.

The second most common operational defect we find during plan audits is improper application of the plan's eligibility provisions, particularly in regard to automatic enrollment and automatic escalation. To increase plan participation rates, many qualified retirement plans include an automatic enrollment feature in their plan design which automatically schedules employees for salary reductions (deferrals) into the plan at a default rate. Some of these plans are designed to increase the automatic contribution rate annually or over some other period of time. These plan design provisions are not, however, always followed. We often find employees who were never automatically set up to make deferrals into the plan or groups of employees whose deferral rates were never increased. Both of these administrative errors are qualification issues.

Lastly, another common qualification defect we find during plan audits is the failure of the plan to properly conduct non-discrimination testing, due to the use of incorrect data, including but not limited to taking into account proper compensation (as defined in the plan document). Tests are only as good as the data used to perform them, so it is crucial for the employer to give the plan's recordkeeper accurate information before they run the testing. If a non-discrimination test (such as an ADP or ACP test) is failed, there is a limited period of time in which the plan administrator must take corrective action so that the plan does ultimately pass the failed test.

Callan: As the independent auditor, are there any steps you must take when you find an error?

Diane: Yes, in any financial statement audit of a plan, there is a risk assessment process which leads to designing audit procedures to address the noted risks. At the core of auditing is the testing of a sample of the total employee population and then assessing the results of that testing. When a plan error is noted, the auditor must determine how to respond to the error. Responses may include testing a larger sample or obtaining additional information in a particular affected area. With benefit plans, errors carry a broader consequence given the impact that errors can have on a plan's qualified tax status.

Callan: What can plan sponsors do to prevent these and other errors from occurring?

Diane: Surround themselves with a highly qualified plan auditor, a knowledgeable plan recordkeeper and ERISA counsel! Fiduciaries should take their role more seriously and review the plan themselves before we start our review process. They should actively read the plan document and amendments, and compare them to the way the plan is actually being operated. Many plan sponsors monitor only the plan's investments and avoid the more administrative, day-to-day aspects of the plan, which can lead to systemic errors. If the plan sponsor or administrator finds an error, consult with qualified professionals to correct it as soon as possible.

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Common Retirement Plan Errors and How to Avoid Them

For the rest of this conversation and more information on these and other qualified retirement plan issues, join Callan, Diane and Courtney Alexanderson (an Audit Partner in Eisner Amper's Financial Services Group) for a **free webinar** that will discuss issues that employers need to be aware of in the administration of their retirement plans. Topics will include common plan errors, fiduciary responsibility, correction programs and data security best practices.

January 23, 2018

10-11 am PT • 1-2 pm ET

Register here

FIRM NEWS

On November 14, **Kevin Nolt** was a panelist in a webinar entitled, *ERISA Pre-Approved and Customized Benefit Plans: Overhauled IRS Procedures and Determination Letter Process*, hosted by Strafford.

On January 23, 24 and 25, **Marc Fosse** will be speaking at several roundtable discussions on Executive Compensation for Non-Profit Health Care Providers. The events will be co-sponsored by Trucker Huss and Willis Towers Watson, and will be held in La Jolla, Los Angeles and San Francisco. To register, click on the following links:

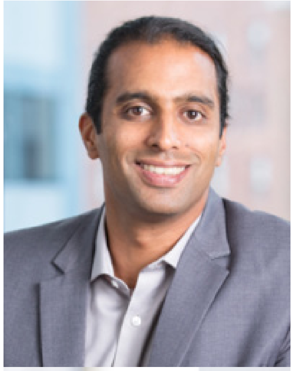
La Jolla: January 23, 5:30–8 PM
Los Angeles: January 24, 11:30 AM–2:30 PM
San Francisco: January 25, 4:30–7:30 PM

On January 25, **Nick White** will present on *Party In Interest Transactions* at the LA Advanced Pension & 401(k) Conference held at the Hilton Los Angeles in Universal City. The conference will focus on networking and education with hands-on learning about current regulatory, legislative, administrative, actuarial and consulting topics from session leaders who are industry experts.

On February 22, **Marc Fosse** will participate in a webinar entitled, *The Tax Cuts and Jobs Act: How It Will Impact Executive Compensation* (12 Noon–2 pm PT, 3–5 pm ET). The webinar is being presented by The Knowledge Group, LLC.

Disability Claims Regulations Delayed to April 1, 2018

YATINDRA PANDYA
AND JAHIZ NOEL AGARD



On November 24, 2017, the Department of Labor (DOL) delayed the applicability of the final rule which revises the regulations governing disability benefit claims (the "Final Rule") to April 1, 2018, from the original January 1, 2018, effective date.

Published in the Federal Register on December 19, 2016, the Final Rule added to and revised the disability benefit plan claims regulations to include many of the procedural protections afforded to health plan claims under the Affordable Care Act. The DOL delayed the Final Rule to give affected service providers additional time to make necessary adjustments and to give consumers time to understand the changes.

The New Disability Claims Procedure Regulations under the Final Rule

The Final Rule modified the existing procedures for disability claims in the following areas:

- **Independence and Impartiality.** Plans must ensure that the disability claims and appeals process is designed to be independent and impartial.
- **Disclosure Regarding Denial Details.** Benefit denial notices must contain a more complete discussion of why the plan denied a claim and must articulate the standards used in making the decisions (including the reasons for disagreeing with disability benefit determinations by the Social Security Administration).
- **Notice of Right to Access Information.** Claimants must be given timely notice of their rights to receive upon request the entire claim file and other relevant information.
- **Opportunity to Review and Respond to New Information.** Claimants must be given notice and a fair opportunity to review and respond to new or additional evidence or rationales before denials at the appeals stage can be based on such new information.
- **Disclosure of Any Contractual Limitations Period.** Denial notices must include a description of any applicable contractual limitations period and the date on which such period expires.
- **Deemed Exhaustion of Claims and Appeals Processes.** Unless it is a minor error, when a plan does not adhere to its claims processing rules, the claimant is deemed to have exhausted the administrative remedies and is therefore permitted to file a lawsuit under Section 502(a) of the Employee Retiree Income Security Act (ERISA).
- **Retroactive Rescissions of Coverage Are Appealable.** Certain rescissions of coverage are to be treated as adverse benefit determinations triggering the plan's appeals procedures.
- **Communications Requirements in Non-English Language.** In certain situations benefit denial notices must be provided in a non-English language,

using essentially the same standards applicable to group health benefit notices under the Affordable Care Act.

For a comprehensive discussion on the provisions of the Final Rule amending disability claims procedures, see the article by Tiffany Santos, and for the Final Rule's applicability to nonqualified deferred compensation plans, see the article by J. Marc Fosse.

Reasons for the Delay

After the Final Rule's publication in 2016, the DOL heard from various stakeholders and certain members of Congress who asserted that the Final Rule would drive up the cost of administering disability benefit plans, cause an increase in litigation and consequently limit workers' access to disability insurance. In light of those concerns, and in line with Executive Order 13777 (which seeks to reduce the regulatory burden on the American people), the DOL said that it decided to delay the Final Rule, in order to allow it to carefully consider more comments and data, as part of its effort to examine various methods to ensure the full and fair review of disability benefit claims without the imposition of any unnecessary cost or adverse consequence.

After publishing a request for comments in the Federal Register on October 12, 2017,[1] the DOL noted the following areas of the Final Rule and quoted some of the corresponding concerns of certain stakeholders to justify the delay:

- **Disclosure Regarding Denial Details:** This provision forces a plan "to consider disability standards and definitions different from those in the plan."
- **Opportunity to Review and Respond to New Information:** This provision "complicates the processing of disability benefits by imposing new steps and evidentiary burdens" on the plan in making its decisions regarding claims.
- **Deemed Exhaustion of Claims and Appeals Processes:** This provision "explicitly tilts the balance in court cases against plans and insurers" and "creates perverse incentives for plaintiff's attorneys to side-step established procedures and clog the courts for resolution of benefit claims."

In addition to the above concerns, the DOL stated that although it requested data when it first proposed revising the procedures in April 2015, the comment letters received generally did not contain the data needed to adequately estimate the overall costs and benefits of the Final Rule. Furthermore, the DOL pointed out that Executive Order 13777 (introduced after the publication of the Final Rule) directs federal agencies to engage in specific activities to accomplish the goal of reducing the regulatory burden placed on the American people.[2] These activities include evaluating existing regulations for repeal or modification to make them less burdensome and seeking input from entities significantly affected by regulations.

Accordingly, in the November 24, 2017, announcement, the DOL concluded that it was appropriate to seek additional public input regarding the Final Rule, with the comment period ending on December 11, 2017. In the proposal regarding the delay, the DOL identified very specifically the type of data it is seeking to determine whether the benefits of the Final Rule outweigh the costs.

Reactions to the Delay

In its November 24, 2017, announcement, the DOL stated that it received approximately 110 comment letters. On the one hand, opponents of the delay (including those representing disability benefit plan claimants) argue that disability benefit plan claimants are in greater need of procedural protections under ERISA. They also generally discount the usefulness of the 90-day delay, arguing that if the sought-after data existed, the industry stakeholders would have produced it much earlier in the multiyear rule-making process that ended in 2016.

On the other hand, many commenters (primarily those representing employers, plans, insurers and service providers) asked for more time (from 6 months to a year) before the Final Rule becomes applicable. These commenters reiterated much of what had been said before the proposal for delay, i.e., that the Final Rule will result in increased cost and litigation, and that more data needs to be analyzed.

What Happens Next?

The DOL noted that it does not expect to take any further regulatory action without first affording the public the opportunity to review and comment on the data and information received under the 60-day comment period which ended on December 11, 2017.

While it is possible that the Final Rule may be changed or further delayed, the DOL stated that, given what is in the public record to date, delaying the applicability date beyond April 1, 2018, probably would be unwarranted. Noting that several provisions in the Final Rule essentially reflect federal court decisions interpreting the full and fair review requirements of the regulations currently in effect (i.e., from 2000), the DOL stated that the delay in the applicability of the Final Rule would not modify or otherwise delay the application of any such controlling judicial precedents.

Stay tuned for a future update.

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[1] The comment period for the proposed delay ended on October 27, 2017.

[2] Executive Order 13777 closely followed Executive Order 13771, which directs federal agencies to identify two existing regulations for repeal for every new regulation issued and to manage expenditures so that the total incremental cost of all new regulations is no greater than zero.

Due Date for Providing ACA Coverage Forms to Employees/Participants Extended from January 31, 2018 to March 2, 2018

TIFFANY N. SANTOS

Just before the start of the new year, the IRS issued Notice 2018-06, automatically extending to March 2, 2018 the due date for applicable large employers (generally those with 50 or more full-time employees) to furnish the Form 1095-C to full-time employees (pursuant to Section 6056 of the Internal Revenue Code [the "Code"]) — and for providers of health plan coverage (i.e., insurers and self-funded plans) to furnish the Form 1095-B to covered individuals (pursuant to Section 6055 of the Code). While the final regulations implementing Sections 6055 and 6056 provide for a January 31 due date, the IRS determined that a substantial number of employers, insurers and other providers of coverage (such as multiemployer plans) need additional time to gather and analyze information, and furnish the requisite forms. Similar extensions were provided for 2015 and 2016 reporting. The extension affects coverage offered/provided in 2017 for which reporting is due to employees/covered individuals in 2018. (Note: Taxpayers who file their tax returns prior to receiving the Form 1095-B or 1095-C may rely on other information provided by their employer or coverage provider when completing their returns in order to substantiate eligibility for the premium tax credit under Section 36B or to confirm that they had "minimum essential coverage" during the year.)

Transition Relief Also Available for Incorrect or Incomplete Forms. Similar to relief extended for reporting required in 2016 and 2017, the Notice also provides for transition relief from penalties under Sections 6721 and 6722 for forms that include incorrect or incomplete information (for example, missing or incorrect Social Security Numbers or dates of birth). The relief is available if a good faith effort is made to comply with the regulations — i.e., for forms that are actually furnished and filed by the applicable due dates.

No Extension of Deadline to File Forms with IRS. While employers and providers of coverage will have additional time to furnish forms to employees and covered individuals, the due dates for filing the forms with the IRS have NOT been extended. This means that the due date for filing Forms 1094-B, 1095-B, 1094-C or 1095-C remains **February 28, 2018** for paper filing, or **April 2, 2018** for filing electronically.

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The Trucker ✦ Huss *Benefits Report* is published monthly to provide our clients and friends with information on recent legal developments and other current issues in employee benefits. Back issues of *Benefits Report* are posted on the Trucker ✦ Huss web site (www.truckerhuss.com).

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