

Employee Benefits Tax Tips & Oddities

Florida Public Human Resources Association
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TAX TIPS

Taxation of Spousal/Domestic Partner Coverage

- *US v. Windsor*, 133 S. Ct. 2675 (2013): same-sex and opposite-sex marriages are the same for tax purposes
- The coverage for same-sex spouses and opposite-sex spouses → pretax
- Coverage for same-sex domestic partners and opposite sex domestic partners → after tax basis

Taxation of After-tax Coverage

- Applies to...
 - Same-sex domestic partners
 - Opposite-sex domestic partners
 - Older children (ages 27-30)
- After tax basis
 - Premium paid by employee is after-tax
 - Premium paid by employer is included as income (“income attribution”)

Taxation of After-tax Coverage (cont'd)

- Income attribution - valuing coverage
 - COBRA method
 - Tier differential method
 - Additional premium method (employee +1)

Wellness Incentives

- A reward
 - cash payment, PTO, plaques, T-shirts, mugs
 - reduced premiums, deductibles, copays
- A penalty
 - unreimbursed program cost (ex-smoking cessation)
 - increased premiums
- “Penalty” = “Reward”

General Rules With Incentives

Incentives for participating are permitted (but may need to satisfy ADA limits if medical information or examinations are involved)

Incentives based on “successful completion” must satisfy requirements

(eligibility, incentive limits, likelihood of improving health, burden level, potential for discrimination based on health factors, disabilities, and genetics)

Taxation of Wellness Incentives

- Wellness program incentives or rewards are not subject to their own tax exemption
 - the taxation of such rewards depends on what is provided, how the recipient uses the reward, and whether there is a separate tax provision that applies.
- The "default" tax rule is that any amounts received by an employee from his employer should be treated as taxable income unless an exclusion applies

Wellness Incentive Exclusions That Work

- Reduced medical insurance: IRC § 105
- Health FSA contribution: IRC § 125, 105
- Dependent care FSA contribution: IRC § 129
- De Minimus fringe: IRC § 132
 - Cash is never de minimus
 - Gift cards = cash
 - Coffee mugs, plaques, and T-shirts can be de minimus

Potential Exclusions That Rarely Work

- IRC § 74(c) Employee achievement awards: awards of tangible personal property that are
 - for either “length of service achievement” or “safety achievement;” and are
 - awarded in a “meaningful presentation”; and are
 - not a disguised payment of compensation
- IRC § 132
 - “Working condition fringe:” property or services provided that would have been deductible by the employee as a business expense
 - “No additional cost service:” providing service to employee for free if the service does not trigger a significant employer cost
 - “Qualified employee discount:” gift/sale to employee of what normally sell to customers – employee must at least pay employer cost

Florida Legislation v. IRS Regulation

DB V. DC ODDITY

Background - IRS

- Deferred Retirement Option Programs
 - IRS issued rulings and guidance in past
 - Concerned about DROPs that allocated actual earnings (and losses)
 - Primary features of DB plans
 - Employer bears risk of losses
 - Participants can always calculate their exact benefit

Background – IRS (cont'd)

- IRS “held” all FDLs for all governmental DBs with DROPs that allocated actual earnings
- Sent letters asking how the DB plan can provide “definitely determinable benefits” if actual earnings and losses affect distributions
- Probably wanted these operating as separate DC plans (with 415(c) testing)

Current Status

- Still in limbo
- Numerous responses submitted
- Rumor: “winning argument” based on 1970s IRS rulings
 - Benefits only need to be “definitely determinable” at NRA
 - After NRA, can adjust for earnings

Background - FL

- Chapter 2015-039, Laws of Florida
 - Significant changes to 175/185 (Fire/Police Plans)
 - Requires establishment of DC plans to receive some IPT \$\$\$
 - Probably a “share plan”

Share Plans

- IPT \$\$\$ divided equally among participants (or based on YOS)
- Participants given “shares”
 - Book accounts usually
 - Actual accounts sometimes
- Income allocations?
 - Usually “actual”
 - Based on fund returns or participant-elected investments

Early Share Plan Recommendations

- STILL WAITING ON IRS DECISION WITH DROPS!!!
- Share plan allocations to participants < NRA
 - DROP argument might not work
- Create separate 401(a) plan (415(c) limit - \$53,000 for 2015)
- Allocate “assumed” earnings
- Allocate \$0 earnings
- Allocate actual earnings, but limit losses*

IMPROVE PRODUCTION

Paying for Unused Leave = Incentive Not to
Use Leave

Reduce the Cost of Unused Leave and/or
Provide More

Unused Leave Options

Issue	Cash Pmt on Term	Pension/403(b)	Caf/Health Plan
Income taxation	Taxable	Tax-deferred	Tax-free
Employment taxation	Taxable	Tax-free if mandatory	Tax-free (limited ee choice available)
Timing	Annual and/or on termination	Same as cash	Payroll
Cost/Value	Unless annual, often increases as employee compensation increases	Same as cash	Valued at compensation rate when paid
Year of Ee Term	Ee gets full payment	Ee gets full contribution	Ee forfeits whatever was not used for benefits

Dual income families? Single parents?

- Dependent Care Assistance Program FSA
 - Care for children or adults (modified IRC §152 definition)
 - Employer is responsible for reimbursements
 - Reimbursements can be limited to what employee actually contributed
- Amounts contributed are exempt from income and employment taxes
- Receiving DCAP benefits reduces eligibility for dependent care tax credit (IRC §§ 21 & 24)

Affordable Care Act

ODDITIES

ACA Safe Harbor (Background)

- “Safe Harbor”: use lookback measurement periods and stability periods in order to be able to use prior hours of service to predict future hours of service & eligibility
 - If done properly, employer is not liable for inaccurate predictions
- Measurement & stability periods can be 12 months or less, and must be the same, unless the measurement period is less than 6 months (stability period cannot be less than 6 months)

ACA Monthly Assessment Periods

- If using monthly assessments,
 - cover for 1st month PT becomes FT
 - cease coverage for 1st month in which cease to be FT
 - Average 30 hrs/week/month
- Liable for miscalculations

ACA & PT-FT Transfers

- If using lookback MPs...
 - Change of an ongoing employee is captured during the following stability period
 - Change of a new hire
 - PT to FT: must offer coverage, effective by the 1st day of 4th month following the change (unless initial measurement period ends and coverage is required sooner)
 - FT to PT: change captured during next stability period
 - PT to FT to PT: ???

Effect Of Reduced Hours Of Service

- Delayed effect if using safe harbor
 - effect can be delayed for a number of months
- Ex: Employer uses a 12 month look back measurement period and stability period
 - Fluctuations in hours only affect coverage every 12 months
 - FTE changes to PTE in month 10...
- Ex: Employer uses a 6 month look back measurement period and stability period
 - Fluctuations in hours only affect coverage every 6 months

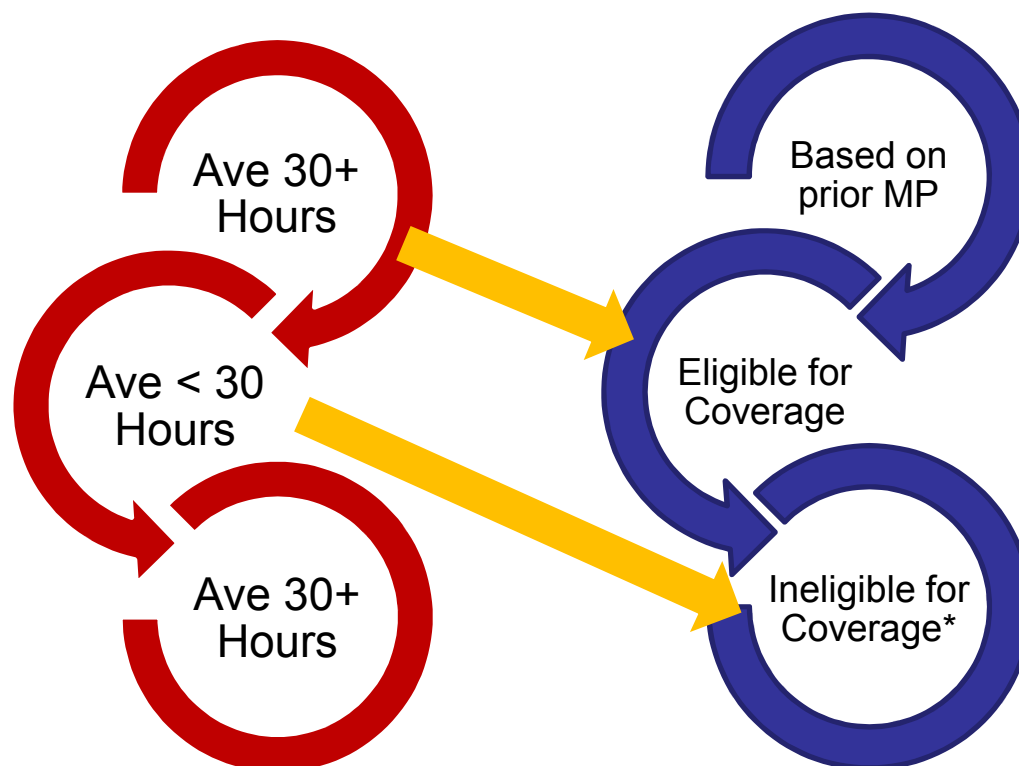
Fluctuating Eligibility

Measurement Periods

Stability Periods

Maximizing the number of employees whose eligibility fluctuates →

- eligibility for coverage when least productive
- eligibility for coverage when more costly to employer (due to 9.5% limit)
- ineligibility when most productive



* Probable COBRA event

ACA & COBRA Oddity

- COBRA BACKGROUND
 - Loss of coverage because of reduced hours → COBRA event
 - Loss of coverage because employer stops offering coverage to a group of employees → no COBRA event
- ACA background
 - Employees working 30 hours/week/month must be eligible for coverage
 - No ACA prohibition on “managing” employee hours
 - Employment law claim may depend on employment or union contracts

ACA & COBRA Oddity (cont'd)

- SCENARIO: employer offered coverage to all employees, but due to ACA affordability requirements (9.5%), employer is...
 - only offering coverage to employees working 30+ hours/week and
 - reducing some employee schedules
- SIDE EFFECT
 - Covered employees working < 30 hours → loss of coverage with no right to COBRA
 - Covered employee whose hours drop below 30 hours per week → loss of coverage with COBRA rights.

Health & Retirement Plan REQUIRES

Rehires & ACA

- New hires/continuing employees treated differently
 - Waiting periods are for newly-eligible individuals
 - Prospective measurement periods (for new variable hour employees) v. lookback measurement periods (for all ongoing employees)

Rehires & ACA (cont'd)

- Former FTE who participated in plan
 - If “new hire”
 - Prospective MP might apply
 - Waiting period may be imposed
 - If not “new hire,” must be offered coverage effective 1st day of following month following their 1st hour of service

ACA & Rehires (cont'd)

- 13 weeks with no hour of service = new employee
 - 26 weeks for educational organizations
 - Former ee returning sooner = continuing employee
- “Rule of Parity”

Rule of Parity

- Compare break in service to weeks of service prior
 - Break in service $>$ weeks of total employment
= new employee
- Employee terminates after 4 weeks of employment; returns in 5 weeks
- Employee terminates after 6 weeks; returns in 7

Rule of Parity (cont'd)

- Optional
 - Must elect
 - Formal policy
 - Internal memo
 - Must elect a minimum employment term
 - Ex- “Will only apply to employees terminating after X weeks of service”
 - Cannot apply to those with fewer than 4 weeks of service

Retirement Plan Rehires

- Why important? Pension distribution restrictions!
 - DB plans and money purchase pension plans
 - No distributions before NRA or termination of employment
- Definition of “term’n of employment”
 - Termination of employment where future services are not anticipated
 - Including services as an independent contractor

Retirement Plan Rehires (cont'd)

- Ex: Ee terminates employment as police officer on day 1; prepares benefit distribution elections on day 3; becomes re-employed in different position on day 7
- Ex: Ee terminates employment on day 1; prepares benefit distribution elections on day 3; starts receiving benefits on day 20; seeks reemployment on day 25?
- Do facts indicate an expectation of rehire by the er?

Expectation of Rehire

- Facts and circumstances
 - Was there an agreement between City & ee?
 - Written or verbal?
 - Did ee know s/he would be rehired because of valuable knowledge/experience?
 - Probably OK
 - Passage of time is just a factor
 - Longer time → more likely no pre-agreement

Improper Payments to Rehires

- Inappropriate distributions → “qualification error”
 - Taxation of all vested amounts
 - Loss of employment tax exemption
 - No rollovers
- Corrections
 - Stop payments (if annuitized) & retrieve improper payments
 - Amend plan to allow distributions

Correcting Improper Payments

- Retrieve improper payments
 - From participant
 - From plan sponsor
 - From future benefits
- Amend plan to allow in-service distributions
 - Likely requires IRS VCP filing (application fee)
 - The in-service distribution must be allowed under IRC

IRC: Distributions at NRA

- Age 62
- Age 50, for police and firefighters
- Any age at which most people actually retire in that industry
- NRAs based solely on service (ex – “30 years and out”) are not allowed

Governmental NRAs

- NRA restrictions only matter for in-service distributions
- In-service distributions only matter if ees will terminate employment to access benefits
- Special NRA for in-service distributions might work
 - Reach NRA at 30 YOS, but no in-service distributions before age 62

COBRA ODDITIES

COBRA & Divorce Oddity

- Background
 - COBRA grants continuing coverage rights to certain individuals in certain situations
 - open enrollment elections will not usually trigger COBRA obligations
 - Ex1: Employee who declines coverage during open enrollment the year after he or she participated does not trigger COBRA
 - Ex2: Employee with family coverage decides during open enrollment to elect employee-spouse coverage; children do not have COBRA right

COBRA & Divorce Oddity (Cont'd)

- **EXCEPTION:** If an employee drops spousal coverage “in anticipation of divorce,” the spouse may have COBRA rights
 - Employee’s election must have been “in anticipation of a divorce”
 - Employee and spouse must get divorced
- **SCENARIO:** wife files for separation; husband drops wife from coverage during open enrollment; before the separation is finalized, but after open enrollment ends, the two reconcile and are prepared to live happily ever after

COBRA & Divorce Oddity (Cont'd)

- Employee did not elect spousal coverage so she is not enrolled
- No divorce = “anticipation of divorce” rule does not apply
- Not newly married, so the HIPAA special enrollment rule will not give her a special enrollment right
- Technically, the spouse has no right to enroll in the plan, neither through COBRA nor otherwise.

FMLA & COBRA Background

- Eligible employees with employers subject to FMLA can take leave in certain circumstances, like serious illness
 - employer-provided medical benefits must continue on same basis as with active employees
 - nonpayment of premiums can trigger a loss of coverage for remainder of FMLA leave
 - Coverage must be reinstated upon his or her return
- COBRA background
 - loss of coverage due to hours reduction → COBRA event
 - loss of coverage due to termination → COBRA event
 - loss of coverage due to nonpayment of premiums → no COBRA event

FMLA “Situations”

- Employee on unpaid FMLA leave fails to pay their premiums → coverage is permissibly cancelled
 - Cancellation does not trigger COBRA
- SITUATION 1: employee gives termination notice
 - COBRA event
 - treated as if coverage was reinstated and then lost due to a termination of employment

FMLA “Situations” (cont’d)

- SITUATION 2: unpaid leave continues (nonFMLA) and employee continues to not pay premiums
 - QUESTION: “Does the employer plan allow employees on unpaid leave to participate?”
 - Most, but not all, either allow participation or are silent

FMLA “Situations” (cont’d)

- If Plan excludes employees on unpaid nonFMLA leave...
 - loss of coverage is due to hours reduction → COBRA
 - treated as if employee re enrolled and then lost coverage
- FMLA leave → return to employment → re-enrollment → unpaid nonFMLA leave → loss of coverage due to hours reduction

FMLA “Situations” (cont’d)

- If Plan does not exclude employees on unpaid nonFMLA leave...
 - employee’s failure to pay triggers (continued) loss of coverage
 - treated as if the employee reenrolled, and then failed to pay their premium
 - failure to pay premiums is not a COBRA event
- FMLA leave → return to employment → re-enrollment → nonpayment of premiums → loss of coverage due to nonpayment

THANK YOU!

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