# 1095 Reporting—

## *What You Don't Know Could Be Expensive*

*by* | **Howard M. Gerver**

Employers that failed to file or made errors on Forms 1095-C to every employee and 1094 submissions to IRS face stiff penalties. This article describes likely IRS audit red flags and potential risks in three areas.

benefits
MAGAZINE

Picture this: You just spent an entire year assembling your bike from 100 separate parts using your step-by-step www.CheapBikes.com instructions. Every part is used, and you're ready to give it a ride. Or so you think.

Every employer with 50 or more full-time employees had 2015 and part of 2016 to assemble its 1095-C forms and 1094 Internal Revenue Service (IRS) submission for the very first time. Serious penalties for getting the forms wrong are a real possibility, although many risk-taking professionals relied on the ambiguous "use best efforts" advice from IRS as an excuse for noncompliant reporting.

How do you feel about your organization's efforts? Was it smooth sailing or fraught with a lot of elbow grease and big efforts, especially close to deadlines, from not just your team but also the vendor your organization used?

You may be confident the reports required by the Affordable Care Act (ACA) were filed with IRS on time and every full-time employee who worked for your organization—an applicable large employer (ALE) as defined by ACA—received a 100% accurate 1095-C form. Even better is that because all the forms were distributed by the March 31 deadline, your organization won't be subject to penalties that IRS could have imposed had the forms been late.

But as the figure illustrates, IRS expects to collect billions of dollars in penalties. In spite of "best effort" rhetoric, these amounts will be realized only through the act of aggressively levying penalties in one of two categories: the employer mandate or Form 1095-C compliance. Since there likely will be a lengthy lag, IRS won't start collecting employer penalty revenue until 2017.

Employers can be penalized for the following form-based noncompliance issues: (1) failure to file—$250 each—and (2) forms with erroneous information—$250 each. Special rules apply for intentional disregard to file. The maximum penalty for any employer is $3 million. Because these are penalties, this expense is not tax-deductible. Employers can also be penalized for failure to offer coverage to ACA-eligible employees and plans that are not affordable. The majority of this article pertains to forms with erroneous information.

You hope and believe that your staff and vendor did everything to ensure that the reports were accurate and reflect the information at hand about each and every employee, active and inactive, who was eligible for medical benefits during the 2015 calendar year.

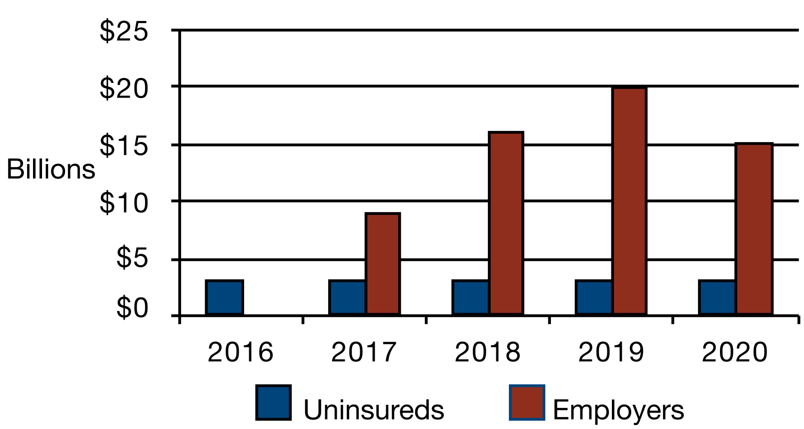
However, given human nature and "what you don't know you don't know," it's possible your 1095/1094 team/vendor may not have caught everything and the organization will be penalized. Moreover, if processes remain status quo, errors that were missed will likely be repeated, and the penalties will be even higher in the future.

Why might there be errors? Any combination of reasons ranging from the integrity and completeness of data to ambiguity over reporting requirements to vendor incompetence could be to blame. You may want to question:

- Did *every* benefits-eligible employee really receive a 1095-C?
- Are the job classifications for each employee *accurate*?
- Were all subsidiaries and joint ventures (aggregated members) *included*?
- How accurate were the codes on lines 14 and 16? What about the monthly premium amount on line 15?
- Were Social Security numbers *accurate*?
- If the plan is self-funded, *were all covered individuals included*?
- If any of this information is wrong and gets submitted to IRS, *is this going to be a problem for my organization?*

FIGURE

**Expected Penalty Revenue of ACA (In Billions)**




*Source:* Congressional Budget Office.

And the biggest question: Is my organization at risk of receiving a penalty from IRS? If left undetected, these errors likely will snowball into material penalties in the coming years.

This article primarily addresses likely audit red flags and potential risks in three areas associated with 1095-C, Part II: offers of coverage, monthly premiums and employee status. It does not fully address other areas where material risks for noncompliance are high: eligibility, job classification accuracy, aggregated ALEs, affordability, Social Security numbers and covered individuals.

## Audit Focus: Offer of Coverage (Line 14)

***What the IRS May Do***

While the spirit of ACA is to have fewer people uninsured, penalties likely are being used to increase coverage. From a financial perspective, IRS seeks to get as much revenue as possible due to noncompliance. IRS likely will focus on the offer of coverage (1095-C form line 14) and employee status (line 16). These codes will help IRS pinpoint individuals having insurance coverage gaps of three or more months, which in turn will trigger the individual mandate penalty.

Moreover, IRS likely will leverage the health insurance exchange data derived from healthcare.gov to identify employers that perhaps failed to make an offer of coverage to an employee who might have been eligible to enroll in an employer plan. When this happens, employers should expect to be asked by the government to prove that all 2015 ACA-eligible employees did in fact receive an affordable, minimum value offer of coverage in a timely manner. This includes waivers and union employees as well.

***What Data Collection and Reporting Is Involved***

Very specific coding requirements apply to the offer of coverage on line 14 of the 1095-C. The appropriate code must be used for each covered individual for each month during the reporting year. If the plan is *off-cycle* (i.e., starts after January 1), the features of the plan (regarding, for example, minimum essential coverage, minimum value, to whom the plan is offered and/or lowest monthly premium) are different or the plan changed midyear, then properly assigning the correct offer of coverage code could be challenging.

Using the wrong code can trigger a penalty. Common codes include 1A, 1E and 1H. To generate a 1A, the plan must:

- Provide minimum essential coverage
- Provide minimum value
- Be offered to the entire family
- Cost less than $93.18 per month in 2015 (employee share of lowest cost option).

Code 1E shares the same characteristics as 1A except the lowest monthly premium for single-only coverage exceeds $93.18. Code 1H means there was no offer of coverage.

While accurate coding is relatively easy for groups that have static populations, it becomes more challenging with dynamic populations that have:

- Significant new-hire activity
- High turnover
- Waivers and buyouts
- Job status changes
- Consolidated Omnibus Budget Reconciliation Act (COBRA) elections
- Many life events (e.g., marriages, new births/adoptions, divorces).

The reporting challenges associated with these business realities are exacerbated by outdated systems, flawed business processes and misunderstanding of how to apply the offer of coverage codes.

## takeaways

- Employers risk costly penalties for failures to provide IRS forms and for making errors on the forms.
- If errors were made and processes remain unchanged, errors likely will be repeated in the future, when fines will be higher.
- Codes used on line 14 of Form 1095-C will help IRS identify individuals with insurance coverage gaps.
- IRS may use health insurance exchange data to identify employers that may have failed to offer coverage to an eligible employee.
- Mistakes in coding may trigger a penalty. While accurate coding is relatively easy for groups with static populations, it is more challenging in populations with high turnover or job transfers affecting benefits eligibility.

## Audit Focus: Monthly Insurance Premiums

***What IRS May Do***

IRS also wants to know about monthly premiums pertaining to the lowest cost plan for single-only coverage. The challenge arises when a government inquiry is triggered by an employee who bought insurance on the exchange and qualified for a subsidy.

***What Data Collection/Reporting Is Involved***

In 2015, if the monthly premium is under $93.18 and a code 1A (qualifying offer) is used in line 14, there should not be any issue as long as it is accurately reported. When IRS instructions are followed, line 15, where the employee contribution is shown, should be left blank whenever code 1A is used. If a 1E is used and the premium exceeds $93.18, this should be fine as long as the premium is accurate and reflects the actual cost of the employee's share of the monthly premium.

## Audit Focus: Employee Status (Line 16)

***What IRS May Do***

Similar to its focus on the offer of coverage as shown on line 14, IRS likely will focus on employee status (line 16) to identify which employers are to be audited. Given its deep tools and resources, IRS has the ability to compare employer enrollment information with healthcare.gov enrollment information.

For example, consider a nonunion employee who has coverage through healthcare.gov and received a subsidy. If the code on line 14 is 1H (no offer of coverage) and the employee is not enrolled in the plan, this likely will trigger an IRS inquiry. To avoid a penalty, the employer will need to demonstrate the employee was, in fact, not eligible.

***What Data Collection/Reporting Is Involved***

Very specific coding requirements apply to the employee status codes shown in line 16. The appropriate code must be used for each covered individual for each month during calendar year 2015. If the wrong code is used, this error can trigger a penalty.

Common codes include 2A (not employed), 2B (part-time or terminated), 2C (enrolled in the plan), 2D (newly hired or newly eligible and in the respective waiting period, which includes ACA-eligible employees in their respective measurement period), 2E (union employee whose coverage is managed by the union) and 2F (if the W-2 safe harbor method is used; other codes are used for other safe harbor methods).

Again, while accurate coding is relatively easy for groups that have static populations, coding accuracy becomes more challenging with dynamic populations that, for example, have high turnover or job transfers affecting benefits eligibility. Moreover, these exposures can be exacerbated by process inefficiencies, data integrity issues and limited HR systems. Given the high cost of penalties, this is an area that could pose significant threats.

## Summary

While everyone knows that "the best way to solve a problem is to prevent it from happening," many organizations still allow it to happen. The best way to mitigate the risk of an IRS audit or being added to the IRS watch list is to be sure employee indicative information as well as the lines 14 and 16 codes "make sense" for a specific business and geography. Why?

The acceptance and use of big data is quickly expanding. It is quite possible for the Social Security Administration to provide W-3 filings that could be linked to 1094 filings and healthcare.gov data. When all of this data is combined, the opportunities to identify compliance issues are quite real. As a result, the risks for penalties will be even higher. If state governments were to furnish quarterly payroll reports with detailed employee earning information, such as the WR-30 in New Jersey or the NYS-45 in New York, the risk would climb even higher.

A perfect storm may be developing. Four elements of this storm are:

- Ambiguous government requirements
- Questionable employer data completeness and accuracy
- Unproven 1095 and 1094 vendor experience
- Giant penalties (none of which are tax-deductible).

IRS is anticipating billions of dollars in ACA penalty revenue. In fact, IRS has added thousands of field agents to enforce the compliance requirements. Moreover, professional advisors including lawyers and certified public accounts are building their controversy departments in anticipation of an onslaught of IRS ACA-based compliance inquiries.

Even though 2016 reporting is due January 31, 2017, plan sponsors need to review their 2015 forms now to ensure any errors that were made are not repeated in the future. Given the fact that many software products and services had inadequate 1095/1094 error checking, it is even more important to make sure 2016 reporting is built on a solid foundation. Moreover, IRS will increase its efforts and will be more aggressive than it was with 2015 reporting. Now is the time to review your data and your forms.

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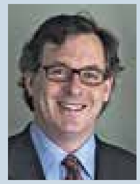

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