

IRS Releases Proposed Regulations under Internal Revenue Code (“Code”) Sections 4980B, 4980D, 4980E and 4980G

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Introduction

The Internal Revenue Service (IRS) released proposed regulations under Internal Revenue Code ("Code") Sections 4980B, 4980D, 4980E and 4980G on July 16, 2008. The proposed regulations include:

- The form and due dates for reporting and paying excise taxes under Code Section 4980B (failure to comply with the Consolidated Omnibus Budget Reconciliation Act (COBRA) requirements), Code Section 4980D (failure to comply with the Health Insurance Portability and Accountability Act (HIPAA) requirements), Code Section 4980E (failure to make comparable Archer Medical Savings Account (MSA) contributions) and Code Section 4980G (failure to make comparable HSA contributions).
- Calculating comparable HSA contributions.
- Special rules for making employer contributions to HSAs for non-highly compensated employees (NHCEs).
- Comparability Rules and Qualified HSA Distributions.

Rules for Reporting and Paying Excise Taxes

Code Section 4980B - Failure to Comply With the Consolidated Omnibus Budget Reconciliation Act (COBRA) Requirements

Excise Tax: Employers that violate COBRA may be subject to both civil sanctions and tax penalties. Under COBRA's civil sanction procedures, either the Department of Labor or plan beneficiaries themselves can sue a plan that fails to provide required COBRA notices to employees. Where a court decides beneficiaries were wrongfully denied continuation coverage, they are entitled to equitable relief. In addition, plan administrators may be personally liable for a special civil penalty of up to \$100 a day for failure to provide the required COBRA notice.

COBRA's tax sanctions include a nondeductible excise tax of \$100 a day for each beneficiary affected during the noncompliance period. However, the tax penalty is capped at \$200 per day with respect to each affected family. For purposes of applying the \$100 a day penalty, the period of noncompliance is measured from the date of the failure to the date when the failure is corrected or the date six months after the last day of the otherwise applicable COBRA coverage period, whichever is earlier. An employer's maximum liability under the tax penalty is limited to the lesser of \$500,000 or 10 percent of the preceding year's total costs of providing group health

Reporting and Due Date: The person liable for the tax must report the excise tax by filing Form 8928, "Reporting of Certain Excise Taxes under Chapter 43 of the Internal Revenue Code." The return must be filed on or before the due date for filing the person's return and must reflect the portion of the noncompliance period for each failure that falls during the person's taxable year. An extension to file the person's income tax return does not extend the date for filing Form 8928.

If the person liable for the tax is a multiemployer plan, the return must be filed on or before the last day of seventh month following the end of the plan's plan year.

Code Section 4980D - Failure to Comply With the Health Insurance Portability and Accountability Act (HIPAA) Requirements

Excise Tax: Code Section 4980D provides for penalty taxes on group health plans that fail to comply with the HIPAA requirements. A tax of \$100 per day is imposed for each day in the noncompliance period for each individual affected. The noncompliance period starts on the day the failure first occurs and ends on the day the failure is corrected.

If there is one or more failures with respect to an individual that have not been corrected before the date a notice of examination is sent to an employer, and that occurred during the same time period as the period under investigation, the maximum penalty will be \$2,500. If the violation is not a de minimis violation, the maximum penalty is \$15,000. These maximum penalties are per individual limitations.

Reporting and Due Date: The person liable for the tax must report the tax by filing Form 8928, Reporting of Certain Excise Taxes under Chapter 43 of the Internal Revenue Code.” The return must be filed on or before the due date for filing the employer’s return and must reflect the portion of the noncompliance period for each failure that falls during the employer’s taxable year. An extension to file the employer’s income tax return does not extend the date for filing Form 8928.

If the person liable for the tax is a multiemployer plan, the return must be filed on or before the last day of seventh month following the end of the plan’s plan year.

Code Section 4980E - Failure to Make Comparable Archer Medical Savings Account (MSA) Contributions

Excise Tax: The penalty for failure to comply with this requirement is the imposition of a tax for the calendar year of the violation equal to 35% of the aggregate amount contributed by the employer to Archer MSAs of employees for taxable years of such employees ending with or within such calendar year.⁸⁸¹ The IRS can waive part or all of the penalty tax if the failure was due to reasonable cause and not willful neglect to the extent that the payment of such tax would be excessive relative to the failure involved

Reporting and Due Date: The person liable for the tax must report the tax by filing Form 8928, “reporting of Certain Excise Taxes under Chapter 43 of the Internal Revenue Code.” The return must be filed on or before the 15 day of the fourth month of the calendar year in which the noncomparable contributions were made. .The tax must be paid at the time when the return is filed.

Code Section 4980G - Failure to Make Comparable HSA Contributions

Excise Tax: An employer that fails the comparability regulations will be subject to a 35 percent excise tax on the total of all HSA contributions to its employees for the year. However, for compliance failures due to reasonable cause and not to willful neglect, all or a portion of the excise tax may be waived to the extent that the payment of the tax would be excessive relative to the failure involved.

Reporting and Due Date: The person liable for the tax must report the tax by filing Form 8928, “reporting of Certain Excise Taxes under Chapter 43 of the Internal Revenue Code.” The return must be filed on or before the 15 day of the fourth month of the calendar year in which the

noncomparable contributions were made. The tax must be paid at the time when the return is filed

Calculating Comparable HSA Contributions

In making employer contributions to employees' HSA, an employer may either base its contributions on the actual months of participation in the employer's High Deductible Health Plan (HDHP) ("pro-rata rule") or the maximum annual amount for the calendar year (based on the employees' HDHP coverage) to the HSAs of all employees who were eligible individuals during the last month of the taxable year, including employees who worked for the employer for less than the entire year. An employer is not required to contribute more than the pro rata amount. If the employer contributes more than the pro-rata contribution for the calendar year to the HSA of any eligible individual who is hired after January 1st of the calendar year, the employer must contribute that same amount on an equal and uniform basis to the HSAs of all comparable participating employees.

Special Rules for Making Employer Contributions to HSAs for Non-highly Compensated Employees (NHCEs)

Employers may make larger contributions for NHCEs who are comparable participating employees than for highly compensated employees (HCEs) who are comparable participating employees. Within the NHCE group, the comparability rules continue to apply. An Employer cannot make larger contributions to the HSAs of HCEs than those of NHCEs.

An employer can make larger HSA contributions to those employees who have individual plus two HDHP coverage than those employees with individual plus one HDHP coverage, even if the employees with individual plus two HDHP coverage are all HCEs.

Comparability Rules and Qualified HSA Distributions

The comparability rules do not apply to those amounts contributed through a qualified HSA distribution (rollovers of Health Flexible Spending Accounts (HFSAs) or Health Reimbursement Arrangements (HRAs) to HSAs) To satisfy the comparability rules, if an employer offers such distributions to any employee who is an eligible individual covered under any HDHP, it must allow such distributions to all employees who are eligible individuals under any HDHP. However, an employer can limit such distributions to those eligible individuals who are covered by the employer's HDHP only.

Effective Date

These proposed regulations are effective for calendar years or plan years beginning after the date the final regulations are published in the Federal Register. However, prior to the effective date of the final regulations, the proposed regulations relating to comparable contributions to HSAs under Section 4980G may be relied on for employer contributions made beginning on or after January 1, 2007.