Bloomberg BNA

Tax Management Memorandum™

Finding Liberation in the Big Picture of the Employer Shared Responsibility Tax

By Greta E. Cowart, Esq.[1]

INTRODUCTION

So much energy has been spent on what the final regulations on the employer shared responsibility tax[2] and the related final reporting regulations[3] (the ''ESRR'')[4] say, that some of the most significant considerations and planning opportunities have been missed because people have focused on the complex details (the trees), did not focus on the bigger picture (the forest), where the forest ends and what the ESRR does not say or does not require. Many have considered these rules as defining eligibility when all they really define is when an employer shared responsibility tax will or will not be assessable on an employer and on which employees of an employer. While the ESRR can be used as eligibility rules, nothing requires that the ESRR define eligibility.

There are ways to utilize the ESRR to minimize an employer's potential exposure to liability for the employer shared responsibility tax. To be able to minimize an employer's shared responsibility tax exposure, the employer must know its workforce, their positions, the business needs and any seasonal fluctuations, turnover, the premiums charged to workers or different groups of workers, the restrictions, if any, on an employer's flexibility to charge different premiums to different work groups and the income levels of the different workers; know when the employer shared responsibility tax can be assessed; and know what the ESRR require and what they do not require. Sometimes what is not said is as important as or more important than what is said. This article is intended to dispel some myths circulating and encourage everyone to take a step back and remember to look at the forest as well as the trees to see the big picture of the employer shared responsibility tax and related reporting rules.

EMPLOYER SHARED RESPONSIBILITY TAX OVERVIEW

Taxes will be assessed under Code §4980H(a) (the ''A Tax'') when an employer fails to offer at least 95% (70% in 2015) of its full-time employees coverage, and satisfaction of this safe harbor's threshold is measured on a month-by-month basis because the tax is assessed on a month-by-month basis. This means the 95% (70% threshold for 2015) must be met on a monthly basis, much like the over-reporting relief under this option to report without separate identification of full-time employees or the 98% rule[5] must be satisfied on a month-by-month basis.[6] This means an applicable large employer member must know who its full-time employees (as defined by the ESRR) are for each calendar month to know it meets the safe harbor percentage thresholds for each month.

Taxes will be assessed under §4980H(b) (the ''B Tax'') when a full-time employee with income below a certain level obtains coverage on the insurance marketplace and obtains a premium tax credit or cost sharing reduction from the marketplace and such employee's employer does not offer him or her coverage that both provides minimum value and is ''affordable'' as determined by the ESRR standards. The B Tax is assessed on individuals at a rate of $3,000 for each such person who obtains a premium tax credit

---

[1] © 2014, Greta E. Cowart. All rights reserved. Greta E. Cowart, Esq. is a shareholder of Winstead P.C., Dallas, Texas. Ms. Cowart practices in the areas of employee benefits, tax and executive and deferred compensation with a focus on health and welfare benefits and healthcare reform implementation.

[2] T.D. 9655, 79 Fed. Reg. 8544 (Feb. 12, 2014).

[3] T.D. 9660, 79 Fed. Reg. 13220 (Mar. 10, 2014); and T.D. 9661, 79 Fed. Reg. 13231 (Mar. 10, 2014).

[4] T.D. 9655, 79 Fed. Reg. 8544 (Feb. 12, 2014).

[5] Reg. §301.6056-1(j)(2). Unless otherwise stated, all section references are to the Internal Revenue Code, as amended, and the regulations promulgated thereunder.

[6] Reg. §54.4980H-5(a); Instructions to Form 1095-C.

per year, while the A Tax is assessed on *all* full-time employees if the threshold is not met at an annual rate of $2,000 per each full-time employee even if the percentage of the safe harbor is a very small amount below the safe harbor threshold.[7] There are different affordability standards: one for the premium tax credit and then a separate set of regulatory safe harbor standards for affordability for the B Tax. The percentage for the premium tax credit the individual receives is indexed per the statute and has been adjusted from 9.5% to 9.56% for 2015.[8] The standard for affordability for imposition of the B Tax in the statute is tied to whether the premium tax credit is provided to an individual.[9] (This will automatically pick up the 9.56% standard when calculated after year end based on the employee's household income for determining which employees were eligible for the premium tax credit.) In order to ease the administrative burden for employers in trying to structure their health plan premium system to avoid the B Tax, the Internal Revenue Service (''IRS'') provided employers with three alternative safe harbors to determine ''affordability'' of their coverage (the use of the safe harbors are included to approximate the percentage of household income standard for the premium tax credit for the individual, but without requiring retroactive determinations or the data on the full household income to make it easier for the employer to plan to avoid imposition of the B Tax).

The B Tax's safe harbor's determination of ''affordability'' is specified in the ESRR regulations as 9.5% of certain income measures (W-2, Rate of Pay and the federal poverty level),[10] but the regulatory safe harbors do not incorporate the indexing provided in the percentage under premium tax credit. This slight inconsistency is something of which the government is aware. The government recognizes the confusion the different percentages cause and hopefully will resolve this difference to provide consistency and to make the law more administrable.

The A Tax and the B Tax are assessed on each applicable large employer member entity. For purposes of this article, references to employers should be read as a reference to the applicable large employer member on which the ESRR is assessed.

REMEMBER THE BIG PICTURE — WHEN AND WHY THE A TAX OR B TAX MIGHT BE IMPOSED AND WITH RESPECT TO WHOM

It is critical to remember the big picture of when the A Tax and the B Tax can be imposed and what triggers such taxes when you look at the complexity of the ESRR and to remember the ESRR are only the rules for tax assessment and for reporting of coverage offers and coverage provided. The ESRR can be used by an employer to plan to capture the data necessary to provide the employer with flexibility in the future calendar years to change its plan's eligibility, testing of full-time employee status and/or premium subsidization structure should economic circumstances change requiring the employer to subsidize the coverage at a lower rate. The tax can be assessed only on the entities which are part of controlled groups of corporations which are applicable large employers.[11] The tax is assessed on the applicable large employer member and reporting is done by the same entity (i.e., the individual legal entity within the controlled group of entities that has 50 or more full-time employees or full time employee equivalents) in certain circumstances.[12]

REMEMBER TO LOOK AT THE ESRR AS A WHOLE AND WHAT THE ESRR DOES AND DOES NOT REQUIRE

While the ESRR include a complex set of rules for determining who is a full-time employee, some rules apply both for determining whether an applicable large employer exists and for determining which individuals are full-time employees on which a tax can be assessed, and not every violation of the complexities will necessarily result in a tax assessment. Some of the rules can only be used to determine if an individual is a full-time employee on whom a tax may be assessed. So each time an employer considers a situation where it may not have followed the ESRR precisely, one should step back and consider whether this is a violation that triggers a tax assessment or if it might be a violation without a consequence. The ESRR does not explain that a violation of many of the rules in the ESRR will not necessarily result in any

[7] The text of this article has simplified the penalty calculation. The Code §4980H(a) penalty is $2,000 for each full-time employee in excess of 30 employees, indexed to inflation. For 2015 only, the penalty will exempt the first 80 full-time employees instead of 30. The penalty under Code §4980H(b) is the lesser of $2,000 for each full-time employee in excess of 30 (80 in 2015) or $3,000 for each full-time employee who receives a premium tax credit to enable him or her to purchase coverage through the health insurance exchanges. See more at: http://www.shrm.org/hrdisciplines/benefits/articles/pages/aca-2015-outlook-employers.aspx#sthash.KrSlPY4f.dpuf

[8] Rev. Proc. 2014-37, 2014-33 I.R.B. 363.

[9] Code §4980H(c)(3)(A) tying the imposition of the B Tax to the premium tax credit under Code §36B including Code §36B(c)(2)(C)(i)(II).

[10] Reg. §54.4980H-5(e)(2).

[11] Code §4980H; Reg. §54.4980H-2, §54.4980H-4 and §54.4980H-5.

[12] Code §4980H(c)(2).

ISSN 0148-8295

tax penalty or other consequences provided the ESRR's rules for determining full-time employee status are not in the plan or not incorporated into a collective bargaining agreement as the determination standard for eligibility for coverage.

UNDERSTAND THE EMPLOYER'S WORKFORCE DEMOGRAPHICS, PLAN ELIGIBILITY AND PLAN COST STRUCTURE

There may be more than one way for an employer to defeat an ESRR tax assessment when the employer considers the ESRR in total, the employer's employees' demographics, the employer's plan's eligibility terms, and the various alternatives an employer has under all other applicable laws, such as alternatives for structuring the employee's share of the premium.[13] If the employer can satisfy the safe harbor for the A Tax, then it can focus on minimizing the B Tax risk. An employer can consider the relevant factors in planning to structure its workforce, compensation program, benefit costs employees pay and benefits program to minimize its potential ESRR tax risk.

An employer should consider these factors and plan, but since an employer is not required to specify how it determines full-time employee status in any document or return filed or furnished, the employer can also make that determination for each work class (based on the groups permitted in the ESRR) after the tax is assessed or after the end of the calendar year with respect to those certain employees in groups on which the assessment is most likely to fall. The employer can make this determination after the fact, provided the employer has data on: hours worked by calendar month for each employee, compensation, leave taken, the employee's status at hire as seasonal, variable hour, part-time or expected to be an ongoing full-time employee, and how each employee fits within the various categories that must be tested together[14] under the lookback/measurement stability rule.[15]

For example, when the employer is assessed a tax for 2015 in 2016 or later years, the employer can avoid the A Tax if it can demonstrate it met the safe harbor to avoid the A Tax (i.e., the employer offered coverage to 70%[16] (2015) or 95%[17] or more of its full-time employees (2016 and later). Many larger employers using lower hourly standards for health benefit eligibility will easily satisfy this, while others who have large collectively bargained populations with contractual coverage requirements may find that this is a safe harbor they will easily satisfy, assuming they do not have a large number of contract workers, seasonal workers, or others not covered by their plans due to outsourcing agreements which have not been modified for ESRR.

If the employer meets the A Tax safe harbor, then the employer only looks at employees for whom the B Tax might be likely to be assessed (assume the 95% rule was satisfied) and must determine whether each employee is a full-time employee under the monthly method or under the lookback/stability measurement period method which can be tested by groups, including hourly or salaried, a member of a collective bargaining group or not, a member of a different collective bargaining unit or a resident of a different state (a different full-time status determination method can be used for each of those different categories).[18] Different methods (monthly vs. one of the various lookback/measurement and stability period testing) of determining monthly full-time employee status can be used to test different categories of employees when the tax is assessed to determine which method produces the lowest B Tax liability for each group. In order to plan to minimize the tax exposure, the employer must start with a clear understanding of when the employer shared responsibility tax is imposed, its workforce demographics and a careful assessment of for whom it is most likely to be at risk for a B Tax assessment or when it might be at risk for an A Tax assessment.

The key thing to remember as one looks at the complexity in the ESRR determination of full-time employee status is that while the complexity is necessary to determine full-time employee status to know whether the A Tax safe harbor applies, *not every slip-up or failure to follow every detail in the ESRR in calculating if an individual is a full-time employee will necessarily result in a penalty under the B Tax*. With that quick review of the big picture, consider what the regulations do not say and what opportunities those openings provide for an employer.

1. *The ESRR does not require an employer to use the ESRR rules for determining full-time employee status to determine plan eligibility.* Plans must only use those rules to determine on whom a B Tax is assessable and how to defend against a B Tax assessment on the wrong person, and whether the A Tax safe harbor is satisfied so the A Tax is not assessed on all of the employer's full-time employees. If a plan provides coverage to all employees working less than 30 hours per week without any exclusions, then it is likely to meet the safe harbor to avoid the A Tax, as-

[13] Code §105(h) and §125.

[14] Reg. §54.4980H-3(d)(1)(v).

[15] Reg. §54.4980H-3(d)(i)(v) and §54.4980H-3(d)(3)(v).

[16] 79 Fed. Reg. 8544, 8570, XV.D.1.

[17] Reg. §54.4980H-4(a).

[18] Reg. §54.4980H-3(d)(1)(v) and §54.4980H-3(d)(3)(v).

ISSN 0148-8295

suming there are no common law employees among the independent contractors working for the employer. Plans can keep their eligibility terms if such eligibility requirements do not exclude coverage for persons who are working 30 or more hours per week or contain exclusions of large groups of employees from eligibility (e.g., excluding all employees working at a facility or all union members or all seasonal workers or interns). If the plan covers employees who generally work 30 or more hours per week on the average, the employer may need to consider whether any changes might be necessary to the plan's eligibility requirements to minimize exposure to the A Tax or B Tax.

For example, for employers that are clearly subject to the Code §4980H tax, the complex rules for determining full-time employee status under the monthly method are not necessary to determine whether the employer has 50 or more full-time employees or full-time equivalent employees and is subject to the tax, so it is not required to use the monthly determination of status for determining if any particular employee is a full-time employee, and it may choose to use one of the variations of the lookback/stability method to determine which employees are full-time employees. If such employer can structure its health benefits offering to ensure that 95% (or 70% in 2015)[19] of its full-time employees are offered coverage, then it only must worry about the B Tax. Such an employer can structure its workforce to meet the A Tax safe harbor by evaluating its workforce including individuals in transitional or short-term positions and evaluating whether independent contractors and leased employees are contractors or common law employees. Once you know the total number of potential employees, then the employer must consider to which of those employees it offers health coverage.

If such employer offers coverage to all employees working a set number of hours per week that is lower than the Code §4980H definition of full-time employees status at 30 hours per week, then such employer must consider whether it has groups of employees such as variable hour or part-time employees, seasonal employees or independent contractors and evaluate if the individuals in these groups might cause the employer to cease to meet the 95% (or 70% in 2015)[20] safe harbor because they may become full-time employees under one of the testing alternatives. Those are the same employees that may put the employer at risk for being assessed a B Tax because their variable work schedules may allow them to slip into full-time employee status and these variable positions are likely to be the ones with lower compensation, making coverage affordability more like to be an issue. Not offering employees full-time positions to avoid the ESRR tax may give rise to an employee claims that they were discriminated against to prevent them from obtaining benefits.[21]

Most employers who have decided to offer coverage to avoid the A Tax can structure their health benefits to avoid imposition of the A Tax by lowering the hours threshold for receiving an offer of coverage, revising staffing or independent contractor relationships or using the change staff leasing contracts which permits the employer to consider the offer of coverage by the staff leasing company as its own offer.[22]

If an employer can alter its offer of coverage to meet the safe harbor threshold for coverage offers for the year (the threshold must be met on a monthly basis since the tax is assessable on a monthly basis), the employer must be able to know to which employees it offered coverage and can use the over-reporting or 98% option on reporting to avoid counting its full-time employees and reporting the number of full-time employees it has to the IRS.[23]

If an employer does not identify particular individuals as full-time employees under the ESRR or identify which employees are full-time employees under the ESRR in advance of offering their coverage until the IRS assesses a Code §4980H tax, then the employer must be able to defend the assessment. An employer may defend against the A Tax or B Tax by showing the individual is not a full-time employee and may defend against assessment of the B Tax by also showing the coverage offered to this individual is affordable and that it provides minimum value. Since the employer is not required to establish or select its method for determining full-time employee status, the employer may defend the assessment of the A Tax or B Tax by using the method which results in the lowest tax liability for the employer, provided the employer has retained the data (showing hours worked by calendar month, classification/category of the employee, compensation, date of hire in present position, status as full-time, part-time, variable hour or seasonal employee, dates of commencement and termination of leave and types of leaves, hours worked by calendar month, and initial rate of compensation per hour for the calendar year) to be able to test whether a particular employee constitutes a full-time employee under any of the various tests and if the employer's coverage was affordable to each employee in question.

Preserving such data permits the employer to recalculate the tax liability under a number of different

[19] Reg. §54.4980H-4(a) and 79 Fed. Reg. 8554, 8575, XV.D.7. (Feb. 12, 2014).

[20] *Id.*

[21] ERISA §510; and *Sanders v. Amerimed, Inc.*, 58 EBC 2483 (S.D. Ohio 2014).

[22] Reg. §54.4980H-4(b)(2).

[23] Reg. §301.6056-1(j)(2).

ISSN 0148-8295

methods (e.g., monthly, lookback/stability with a 12-month lookback stability or lookback/stability method with a three- to 12-month lookback and a six- to 12-month stability period, provided the other limitations and requirements are met). The employer can then test which method of determining full-time employee status on the employees on whom the IRS assesses a B Tax to determine which method produces the lowest number of full-time employees potentially subject to the B Tax penalty.

If the IRS seeks to assess an A Tax on the employer, the employer may use the data to calculate which employees are full-time employees to prove the employer's benefit structure satisfies the safe harbor for avoiding imposition of the A Tax.

2. *The ESRR full-time employee status determination rules are never required to be incorporated into a plan document.* The ESRR never require that their rules for full-time employee status determinations be incorporated into any plan document. However, if an employer chooses to use those rules or some variation on those rules to determine eligibility for its health plan, then the ESRR need to be incorporated into the plan document to the extent such rules are used because the plan document under ERISA must explain who is and who is not eligible and ERISA requires plans to be administered in accordance with their documents.[24] The ESRR also contain alternatives. Thus, employers using the ESRR as the basis for eligibility should be careful incorporating by reference the regulations because the alternatives need to be selected by the employer for its own application of the ESRR. An employer may be able to minimize its potential A Tax and B Tax exposure without adopting all of the ESRR rules on full-time employee status determination depending upon the employer's current eligibility rules for its health plan, the demographics of the workforce and the structure of the employee's health premiums.

The ESRR rules determine for whom an assessable A Tax or B Tax can be assessed against the employer. The ESRR rules determine tax on a calendar month basis. Incorporating the ESRR into a plan document binds an employer to use those complex rules to determine eligibility to follow those rules. There is no requirement to so limit an employer in the administration of its plan unnecessarily or to adopt such limits prior to the employer deciding how to defend itself against a tax assessment.

3. *The ESRR rules never require an employer to identify in advance which method it will use for a particular category of employees for a particular calendar year.* This means an employer does not currently need to decide which rules it will use to determine full-time employee status to defend against any tax assessment for 2015. If an employer does not designate and sets up the data collection in advance (as described above in item 1), the employer must capture the hours worked by calendar month data, the coverage offered and provided by calendar month data, and the other data necessary in order to be able to report and defend against assessment later. Capturing the records (described in item 1 above) now permits the employer to use such data and the ESRR later to determine full-time employee status in different manners to find the lowest potential tax for the employer and also permits the employer to comply with the reporting requirements. Capturing all necessary data for all testing methods is essential for an employer to be able to use retrospective evaluation of full-time employee status under different methods to minimize its tax exposure, if this approach is used to strategically determining how to minimize the employer's exposure for the A Tax and the B Tax.

4. *The ESRR rules do not require an employer to adopt the same rules for determining on which employees an A Tax or B Tax might be assessed for more than one year at a time, but only to use the same method within one of the specified categories of employees for a particular calendar year.* The employer is free to vary the full-time employee status determination methods it will use for its employees each year by each category, and these choices are not required to be specified in a plan document or in any collective bargaining agreement because they are tax rules and not eligibility rules. This permits the employer to have the flexibility in future years to make changes if the economic or business climate changes for the employer. This permits the employer to test different categories of employees using different lookback/stability periods to determine full-time employee status not only in one year, but from one year to the next, to be able to adapt to changing business environments.[25] However, the IRS provided some restrictions on changes in testing methods when the lookback measurement method is used and an employee transfers to a different position measured using a different testing method.[26]

5. *While there are a complex set of rules for determining full-time employee status in the regulations under both the monthly method and the lookback stability method, not every violation of each of those detailed rules will result in any tax issue, and only those that drop the employer below the safe harbor threshold for the A Tax or that result in an employee obtain-*

---

[24] ERISA §402(a)(1).

[25] Reg. §54.4980H-3.

[26] Notice 2014-49, 2014-41 I.R.B. 665.

ISSN 0148-8295

ing coverage and a premium tax credit from the marketplace, if the employee's income is low enough, will result in a penalty. If the employer offers coverage to a broad enough group to ensure it meets the (95%/70%)[27] offer safe harbor, then the offer of coverage must be tested per individual employee to defeat the assessment of a B Tax. There are ways an employer can structure its health coverage offering to low-income employees that might be eligible for the premium tax credit to avoid the B Tax and not violate any of the tax law requirements prohibiting discrimination in favor of the highly compensated.[28] The employer could provide additional subsidization of the lowest income employees' coverage (to make it affordable to the least well paid and preclude assessment of the B Tax) by using the rate of pay safe harbor or the federal poverty level safe harbor.[29]

For example, if an employee takes a leave and returns within 13 weeks and the employer treats the individual not as a continuing employee retaining his status from before the leave, but as a new employee subject to again demonstrating full-employee status, this would be a violation of the ESRR. The individual could be a member of a collective bargaining unit who is required to be covered by the collective bargaining agreement and thus no A Tax or B Tax would result even though the leave was treated as a termination of employment and his status. The individual could be paid at a level above 400% of the federal poverty level[30] and so no B Tax would result because the individual is not eligible for the health care premium tax credit, and if no premium tax credit is obtained, no B Tax could be triggered by such individual.[31]

The following example further illustrates the application of these rules. Assume the employer offered its employees coverage for the year, and part way through the year, one of those employees elects to take a pay increase and moves to work on an as-needed or PRN basis (a status by which they agree to take shifts when they desire and to drop health coverage from the employer). The 20% pay increase for taking the position without benefits and without a set schedule may be selected by the employee for a number of reasons. Some employees moving to this type of position still elect to work enough shifts to be a full-time employee, and this could trigger the B Tax if their income is low enough and they obtain coverage on the marketplace with a premium tax credit. Such an employee would be counted toward the 95% (or 70% in 2015)[32] threshold as a person who was offered coverage so this is not likely to trigger an A Tax. This arrangement could trigger the B Tax, but only if the individual's compensation is low enough to obtain a premium tax credit such as by being below 400% of the federal poverty level for an individual (assuming the state adopted the Medicaid expansion).[33] Thus, the fact the employee elected the higher compensation for his work could preclude the premium tax credit from being available and thus prevent imposition of the B Tax.

The ESRR rules and the existing nondiscrimination rules for self-insured group health plans do not prohibit an employer offering its least compensated employees an additional subsidization of their premiums to keep it affordable for those individuals at risk for a B Tax. The employer would not be required to extend such subsidization to persons who are not likely to be eligible for the premium tax credit as long as the subsidization does not violate any of the tax laws prohibiting discrimination, or any other prohibitions on discrimination. Code §105 and §125, and §2716 of the Public Health Service Act all prohibit discrimination that favors only highly compensated employees.

None of the nondiscrimination rules prohibit discrimination in favor of non-highly compensated employees. The employer could provide additional subsidization for the lowest paid employees (or employees with the lowest hourly rate of pay at the beginning of the calendar year, provided this does not present any issues under collective bargaining agreements with ''me, too'' clauses). This revised premium structure would be intended to assure that the coverage offered to the employees with the least compensation is ''affordable'' for them under Code §4980H(b) so that no premium tax credit would be available to those persons because they were offered coverage that constituted minimum essential coverage, provided minimum value and was affordable.[34]

Structuring the employees' premiums so that the lowest paid persons are offered the most subsidized coverage may involve increasing overall subsidization

[27] *Id.*

[28] Code §125 and §105(h) prohibit discrimination in favor of the highly compensated employees, but do not prohibit discrimination in favor of non-highly compensated employees or in favor of certain groups or members of the non-highly compensated employees.

[29] Reg. §54.4980H-5(e)(2)(iii) and §54.4980H-5(e)(2)(iv).

[30] Code §36B(b)(3)(A)(i).

[31] Code §4980H(b)(1)(B).

[32] Reg. §54.4980H-4(a); 79 Fed. Reg. 8544, 8570, XV.D.1.

[33] Code §4980H, §36B(b)(3)(A)(i).

[34] Reg. §54.4980H-5(a), §54.4980H-5(b) and §54.4980H-5(e); Code §4980H(b)(1)(B), §36B(c)(2)(C). *See also* Notice 2014-69, 2014-48 I.R.B. 903 (regarding the determination of minimum value in certain plans as some plans relying on the minimum value calculator may not be able to rely on this for the full 2015 tax year).

ISSN 0148-8295

or shifting subsidization among groups of employees (provided the change in subsidization for another group is not prohibited by any collective bargaining agreement), but it may provide a mechanism by which an employer can reduce its risk of owing an assessable B Tax with respect to the employees most likely to trigger an assessment.

6. *The preamble to the ESRR discusses that dependents aging out of the health plan might need to be provided coverage to the end of the month; however, the ESRR does not include such a requirement.* Remember the A Tax is avoided as long as coverage is offered to full-time employees and their dependents for each day in a month and the A Tax is assessed if the safe harbor percentage of full-time employees are not offered coverage. Not offering a dependent coverage that extends to the last day of the month after the dependent ages out of the plan mid-month as a dependent of the employee does not impact whether the safe harbors are satisfied because after coverage ceases for the individual as a dependent, he is offered COBRA continuation coverage, and thus he is offered coverage for every day in that calendar month. There is no requirement that the offer be at the same price for every day in the month. Furthermore, a dependent aging out of the employer's health plan's coverage should be offered COBRA coverage for the duration of the month[35] and the full COBRA period and thus the offer of coverage would be provided for the month, and the dependent would be offered coverage for such full month and subsequent months of the calendar year(s) during which COBRA is available. This coverage is offered to the full-time employee and dependents for the full month an employee is counted toward satisfying the A Tax safe harbor on offers of coverage.

While the B Tax is tied to offering coverage that is affordable and provides minimum value, the COBRA coverage would provide minimum value, and coverage affordability is currently tested only on the employee-only premium basis, not on the basis of the premium the family pays or the premium paid by any member of a family that is not the employee, so the B Tax would not be impacted by the offering of COBRA coverage for a portion of the month at a higher premium. Thus, the dependent being offered COBRA suffices to meet the offer of coverage requirement, and the A Tax and B Tax are not impacted by a dependent's coverage dropping mid-month upon attaining the limiting age.

7. *If an employer uses the 98% over-reporting rule, you do not need to determine which of the employees are full-time.* While the 98% rule[36] permits an employer to not include the count of its full-time employees, the employer still needs to know which employees are full-time employees to calculate if the A Tax safe harbors are satisfied. This means the employer will need to know which employees are full-time employees.

8. *The ESRR never state that they are the only rules an employer must consider. The ESRR never state that their rules replace or override any of the existing rules governing how an employer offers health benefits to its employees.* Employers cannot operate their health plans solely based on the ESRR, but must also consider, for example, the cafeteria plan rules and the regulations and guidance defining a change in status which permits mid-year changes in benefit elections. The ESRR do not amend or override the cafeteria plan rules. While the IRS added new election changes under the cafeteria plans to consider some changes required by Code §4980H, not every potential change is covered by the recent guidance.[37] The ESRR and the cafeteria plan rules do not fit neatly together and can produce different results. Remember that both sets of rules apply so that you do not make changes in eligibility or enrollment opportunities mid-year or offers of coverage for ESRR that may jeopardize the pre-tax nature of the benefits under your cafeteria plan. The ESRR would require coverage to be offered using a determination of eligibility on a basis that is not tied to the change in status under the cafeteria plan changing status election rights.

While the determination of full-time employee status for ESRR does not constitute a change in status under the cafeteria plan regulations, there may be a change in status that may be used when an employee becomes a full-time employee under the ESRR.[38] Recognizing that some changes in eligibility status, if the ESRR were used to determine eligibility, may be addressed by the cafeteria plan regulations, the IRS issued a notice permitting certain changes in health plan elections (excluding health flexible spending accounts) if the employee's hours drop below 30 per week or the individual enrolls in coverage on the marketplace, provided certain restrictions are satisfied.[39]

It is important to consider what the ESRR does not say and what this means as employers plan for ESRR for 2016. The above list of what the ESRR does not say is not complete or exhaustive, but is an attempt to pick up some key items and highlight the flexibility these items allow to employers. While employers

[35] Code §4980B(f)(3)(E).

[36] Reg. §301.6056-1(j)(2).

[37] Notice 2014-55, 2014-41 I.R.B. 672.

[38] Reg. §1.125-4; Notice 2014-55.

[39] Notice 2014-55.

ISSN 0148-8295

planning for ESRR face many rules, remember the ultimate objective is to be able to defend against an assessment of the A Tax or B Tax. In order to defend against such tax assessments, the employer must capture and retain the appropriate data and records of hours worked, coverage offered, dates of hire, status in which hired, leave data, category of employment and coverage offered, premiums for coverage and coverage provided all by calendar month (the pay period convention for determination of full-time employee status is only for determining if the employer is an applicable large employer potentially subject to the employer shared responsibility tax, and it is not for calculating the tax on full-time employees each month under the B Tax.)[40]

Coverage offered and provided after transition relief expires must be reported on an annual calendar year basis, but the individual months of coverage will always be reported since the A Tax and B Tax are assessed on a monthly basis. Review each provision providing transition relief to determine exactly what type of transition relief applies and for which year and on which conditions the relief is provided. There is no get-out-of-ESRR-free type of relief once an employer is subject to the ESRR based on its prior calendar year employment statistics.

How the ESRR applies to acquisitions of trades or businesses as asset sales or stock sales may be analyzed in a number of different ways. Employers engaging in acquisitions of assets or stock of another business need to consider how and when those employees will become its full-time employees under the ESRR, as it currently exists, or may exist under future guidance. (The provision for ''predecessor employer'' in the ESRR is ''reserved'' for future guidance.) While the IRS has provided some guidance on changes in determining full-time employee status that may work in a merger or acquisition context,[41] employers should watch for further guidance and how the determination of predecessor employer may impact the imposition of the A Tax and B Tax in the contest of mergers, acquisitions and dispositions. Employers engaged in acquisitions of businesses may want to consider alternative ways to transition employees to their payroll if offering health coverage on the day after the transaction closes is not administratively feasible (e.g., by paying for the employee's COBRA coverage under the seller's plan for the remainder of the plan year, leasing employees from the seller (remember state staff leasing laws) or by setting up a clone plan to the seller's plan to continue the employee's coverage (this requires data transfer at closing, and careful planning is required to accomplish this in a seamless manner for the employees being transferred).

EMPLOYER SHARED RESPONSIBILITY REPORTING CLARIFICATION

Draft reporting forms and instructions were issued in August and updated in October for the employer to use in reporting coverage offered and provided in 2015. The IRS also released questions and answers on reporting on their website. The questions and answers on the reporting of the offers of coverage clarify that the IRS will not impose a penalty for failure to report or for incorrect reporting for 2015 offers of coverage and for coverage as long as the employer makes a good faith effort to comply. IRS personnel have indicated that a good faith effort does require an attempt to comply.

The general method of reporting offers of coverage is by completing the Forms 1094-C (transmittal form) and 1095-C for offers of coverage. There are two alternative or simplified methods of reporting offers of coverage certification of qualifying offers and over-reporting. The questions and answers clarify there must be only one Form 1095-C filed by the employer for each full-time employee. IRS personnel have clarified that employers planning to use the 98% rule to over-report in 2015, must satisfy the 98% requirement in each month in 2015. The draft instructions confirm that the 98% rule must be met for all months in the year and provide clarification on the alternative reporting, but until these are finalized the IRS is not bound by their contents.

Self-insured group health plans also must report the minimum essential coverage provided beginning in 2015 on Form 1095-B and transmit this to the IRS using the transmittal Form 1094-B.

CONCLUSION

While some employers may choose to change their group health plan's eligibility rules to use the ESRR rules in 2015 and subsequent years out of an abundance of caution, an employer need not use the ESRR as its eligibility rules in order to minimize its exposure and comply with the reporting requirements by using the over-reporting method. An employer that does not use ESRR as its eligibility rules must plan to capture the data necessary to defend against the A Tax and B Tax assessments and to comply with the reporting requirements. Employers choosing to not use the ESRR as its health plan eligibility rules can use the flexibility provided in what the ESRR do not mandate to structure its health coverage offering to minimize its A Tax and B Tax exposure. An employer can pro-

[40] Reg. §54.4980H-3(c)(3) and §54.4980H-3(a).

[41] Notice 2014-49.

ISSN 0148-8295

tect itself from the A Tax and B Tax through careful consideration of its workforce, demographics, compensation and benefit structure and other restrictions on the employer — provided the employer captures and retains the necessary data.

Employers should carefully consider whether they want to spend large sums to change eligibility requirements in their plans and in their systems or whether they should design their plan eligibility sufficiently broad to capture the employees who may exceed the 30-hour-per-week threshold on a frequent enough basis to trigger full-time status so that the employer can be certain it satisfies the 95% (70% in 2015) threshold for the safe harbor from the A Tax. The employer should then be able to offer such persons determined to be likely to be full-time employees and offer such employees coverage at least once for each calendar year and then ensure that its systems capture the data necessary to determine which employees are full-time under the various testing methods available for the A Tax and B Tax. The employer can then defend against the assessment using the method for determining full-time employee status of the variable, part-time and seasonal employees using the testing method resulting in the fewest number of full-time employees. The employer can also defend against the B Tax assessment by setting its premiums for the lowest paid employees (other than those covered by Medicaid) so that one of the affordability safe harbors is satisfied, using the rate of pay or federal poverty level method. An employer may want to consider increasing the subsidy for the lowest paid employees because the employer can choose to allocate dollars to cover the Employer Shared Responsibility tax or it can use the funds instead to subsidize its lowest income employees so that their coverage is affordable. It really comes down to considering where the funds are best allocated by the employer.

The analysis of how to minimize the tax risk under ESRR is an exercise in considering different ways to determine who is a full-time employee under the various calculation methods in the ESRR, what is affordable coverage and what is the best way to allocate an employer's limited resources for health care coverage. The ESRR require consideration of different mathematical variations on two fundamental concepts to determine the best way to allocate an employer's human resources. When one steps back and considers the bigger picture of the ESRR and what they do not require, one can be liberated from the extraordinarily detailed requirements of determining full-time employee status under every aspect of the ESRR and instead can focus on the best use of the employer's HR or Benefits budget. When the ESRR are viewed as what they are — rules for tax assessment and not rules for eligibility — then an employer can decide to allocate its resources in the most suitable way. This can include designing health plan eligibility considering the 30 hours per week full-time employee status threshold, but without being bound by every detail of the ESRR determination methods. This will enable the employer to instead focus on capturing the data necessary to test after the end of the calendar year using the different methods for different categories of employees, and avoid programming and reprogramming eligibility each year and communicating these complex rules to employees.

ISSN 0148-8295

ISSN 0148-8295