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The Big Picture of the Employer Shared Responsibility Tax

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Ever since the Treasury Department in early 2014 issued final regulations on the employer shared responsibility tax (ESR tax)[1] and the related final reporting regulations (ESR regulations)[2] under the Patient Protection and Affordable Care Act (ACA), practitioners have spent a large amount of energy focusing on the complex details (the trees) of the tax and regulations. However, to glean the significant aspects and the planning opportunities they offer, it's necessary to focus on the big picture (the forest), including an analysis of (1) where the regulatory forest ends and (2) what the regulations don't say or require.

Many practitioners have assumed that these rules define who is eligible for the ESR tax. In reality, the rules define when the ESR tax can be assessed on an employer and on which employees. While the ESR regulations can be used as eligibility rules, nothing requires that they define eligibility.

However, the ESR regulations can be used to minimize an employer's potential tax exposure. To do so, employers must know :

- their workforce,
- their workers' positions and income levels,
- their business needs and any seasonal fluctuations,
- their employee turnover,
- their susceptibility to the ESR tax,
- what the ESR regulations do and don't require,
- the premiums charged to workers or different groups of workers, and
- the restrictions, if any, on their flexibility to charge different premiums to different work groups.

Sometimes, what isn't said can be as or more important than what is said. This article is intended to dispel some of the myths circulating and remind the reader to look both at the forest and the trees when evaluating the ESR tax and its reporting rules.

Employer Shared Responsibility Tax Overview

A Tax. Taxes will be assessed under Code section 4980H(a) (the ''A Tax'') when an employer fails to offer at least 95% (effective on and after Jan. 1, 2016, although the threshold is 70% for calendar year 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. Yes, this means the 95% (or 70% for 2015) threshold must be met on a monthly basis, much like the over-reporting relief (i.e., the relief under the related reporting regulations permitting an employer who offers coverage to over 98% of its full-time employees to report without determining which employees are full-time employees under the ESR regulations) under this option to report without separate identification of full-time employees or the 98% rule[3] must be satisfied on a month by month basis.[4] This means an applicable large employer member (ALE) must know who its full-time employees (as defined by the ESR regulations) are for each calendar month to meet the safe harbor percentage thresholds each month and avoid the A tax.

B Tax. Taxes will be assessed under Code Section 4980H(b) (the ''B Tax'') when a full-time employee with income below a certain level:

[1] 79 Fed. Reg. 8544 (Feb. 12, 2014).

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

[3] Treas. Reg. § 301.6056-1(j)(2)(2014).

[4] Treas. Reg. § 54.4980H-5(a) (2014); Instructions to Form 1095-C released February 2015.

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- obtains coverage on the insurance marketplace,
- obtains a premium tax credit or cost sharing reduction from the marketplace, and
- isn't offered by an employer coverage that both provides minimum value and is ''affordable'' as determined by the ESR tax standards.

The B Tax is assessed on individuals at a rate of $3,000 for *only those individuals* who obtain a premium tax credit per year. The A Tax is assessed on *all* full-time employees if the threshold isn't met at an annual rate of $2,000 per full-time employee even if the safe harbor percentage is only slightly below the safe harbor threshold.

Affordability. There are different affordability standards: one for the premium tax credit and a separate set of regulatory safe harbor standards for the B Tax.

The percentage for determining eligibility for the premium tax credit the individual receives is indexed per the ACA and has been adjusted from 9.5% to 9.56% for 2015.[5]

The affordability standard for imposition of the B Tax is tied in the ACA to whether the premium tax credit is provided to an individual. [6] This will automatically pick up the 9.56% standard for the individual's taxes when such are calculated after year end based on the employee's household income for determining which employees were eligible for the premium tax credit.

This means that an individual's eligibility for a premium tax credit on the marketplace is measured for eligibility for the tax credit using a premium price of 9.5% of his household income as the affordability analysis for the premium tax credit, but if the employer offered coverage at the same price, it might not meet one of the employer safe harbors for offering affordable coverage because the employer must use 9.5%, without indexing, and one of several specified alternatives for household income that may produce a lower number as the standard for affordable coverage to avoid the ESR tax. The marketplace would treat the employer's premium as affordable, making the individual ineligible for a premium tax credit because the marketplace's threshold for affordable coverage is satisfied, but the employer wouldn't be able to count its coverage as affordable. (This is so because the marketplace's percentage is higher than the employer's percentage for affordability.)

In order to ease the administrative burden for employers that are trying to structure their health plan premium structure to avoid the B Tax, the Internal Revenue Service (IRS) provided employers with three alternative safe harbors to determine their coverage ''affordability'' (the IRS has included the safe harbors 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 ESR regulations as 9.5% of certain income measures (W-2, Rate of Pay and the federal poverty level),[7] but the regulatory safe harbors don't incorporate the indexing provided in the percentage under the premium tax credit. The IRS is aware of this slight inconsistency and recognizes the confusion caused by the different percentages. It is hoped the IRS will make these percentages consistent.

The A Tax and the B Tax are assessed on each ALE member entity. The assessment of these taxes will be based on the employer's reporting of (1) the coverage provided on IRS Forms 1094-B and 1095-B, and on (2) the coverage offered on Forms 1094-C and 1095-C.

Employers should carefully review the final instructions and consider how the coding for ESR tax reporting will apply to various members of their workforce and which groups of persons should be reported on which forms. This is important because self-insured plans may report retirees and COBRA-qualified beneficiaries with different information required on Form 1095-B or Form 1095-C.

Remember the Big Picture – When and Why to Impose the Tax

When examining the ESR regulations, it is critical to remember the big picture of when each tax, the A and B, can be imposed and how they are triggered. The ESR rules are only for tax assessment and for reporting of coverage offers and coverage provided.

The ESR regulations can be used by an employer to plan to capture the data necessary to provide the employer with flexibility in future calendar years to change its plan's eligibility, testing of full-time employee status and/or premium subsidization structure should economic circumstances require the employer to subsidize the coverage at a lower rate. The tax can only be assessed on the entities that are part of controlled groups of corporations that are ALEs.[8] The tax is assessed on the ALE 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.[9]

What the Regulations Do and Don't Require

While the regulations include a complex set of rules for determining who is a full-time employee, some rules apply both for determining if an ALE exists and which individuals are full-time employees on which a tax can be assessed. Not every violation of the rules will 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 discovers a situation where it may not have followed the ESR regulations precisely, it 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.

Nevertheless, even if a violation of the rules doesn't result in a tax, there may yet be consequences if the ESR rules for determining full-time employee status are in the plan or incorporated into a collective bargaining

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[5] Rev. Proc. 2014-37, 2014-33 I.R.B. (Aug. 11, 2014).

[6] 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).

[7] Treas. Reg. § 54.4980H-5(e)(2)(2014).

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

[9] Code § 4980H(c)(2).

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agreement as the determination standard for coverage eligibility.

Workforce Demographics, Plan Eligibility and Plan Cost Structure

There may be more than one way for an employer to defeat an ESR tax assessment as long as the employer considers the:

- ESR regulations in total,
- employee demographics,
- employer's plan's eligibility terms, and
- various alternatives an employer has under all other applicable laws, such as alternatives for structuring the employee's share of the premium. [10]

If the employer can satisfy the safe harbor for the A Tax, then it can focus on minimizing the B Tax risk. To minimize its potential ESR tax risk, an employer can consider the relevant factors in planning to structure its:

- workforce,
- compensation program,
- benefit costs employees pay, and
- benefits program.

An employer should consider these factors and plan accordingly, but because an employer isn't 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 ESR rules) after the tax is assessed or after the end of the calendar year.

The employer can make this determination after the fact, provided the employer has:

- hours worked by calendar month data for each employee,
- compensation for each employee,
- data on each employee's leaves taken,
- the employee's status at hire as seasonal, variable hour, part-time or expected to be an ongoing full-time employee, and
- knowledge as how to the employee fits within the various categories that must be tested together [11] under the lookback/measurement stability rule.[12]

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 (i.e., the employer offered coverage to 70%[13] (2015) or 95% (on or after Jan. 1, 2016)[14] 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. However, other employers that have large collectively bargained populations with contractual coverage requirements may also find that this is a safe harbor they will easily satisfy, assuming they don't have a large number of contract workers, seasonal workers, or others not covered by their plans due to outsourcing agreements that have not been modified for the ESR tax.[15]

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 various lookback/stability measurement period methods.[16]

Different methods (monthly vs. one of the various lookback/measurement and stability period testing) of determining full-time employee status monthly 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 minimize the tax exposure, the employer must start with a clear understanding of when the ESR tax is imposed, its workforce demographics, and a careful evaluation of who is most likely to be at risk for a B Tax assessment.

To know whether the A Tax safe harbor applies, it's necessary to work through the complex language of the ESR tax determination of full-time employee status. The key thing to remember, however, is that *not every failure to follow the ESR rules when doing the calculations to determine if an individual is a full-time employee will necessarily result in a B Tax penalty*.

With that quick review of the big picture, consider what the regulations don't say. . . and what opportunities those openings provide for an employer.

1. *The ESR tax doesn't require an employer to use the ESR rules for determining full-time employee status to determine plan eligibility.*

Plans must only use the ESR rules to determine (a) for whom a B Tax is assessable and how to defend against a B Tax assessment on the wrong person, and (b) whether the A Tax safe harbor is satisfied so the A Tax isn't 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, assuming there are no common law employees among the independent contractors working for the employer.

Plans can keep their eligibility terms if such eligibility requirements don't 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 average, the employer may need to consider changing the plan's eligibility requirements to minimize exposure to the A Tax or B Tax.

For employers that are clearly subject to the Code § 4980H A tax and B tax, the complex rules for determining full-time employee status under the monthly method aren't necessary to determine whether the employer has 50 or more full-time employees or full-time

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[10] Codes § 105(h) and 125.
[11] Treas. Reg. § 54.4980H-3(d)(1)(v) (2014).
[12] Treas. Reg. § 54.4980H-3(d)(i)(v) and 54.4980H-3(d)(3)(v).
[13] 79 Fed. Reg. 8544,8570 XV.D.1.
[14] Treas. Reg. § 54.4980H-4(a).
[15] See Treas. Reg. § 54.4980H-4(b)(2).
[16] Treas. Reg. § 54.4980H-3(d)(1)(v) and 3(d)(3)(v).

equivalent employees and is subject to the tax. Therefore, the employer isn't 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 are full-time employees. If an employer can structure its health benefits offering to ensure that 95% (or 70% in 2015)[17] of its full-time employees are offered coverage, then it only must worry about the B Tax. 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 the employer knows the total number of potential employees, then it must consider to which of those employees it wants to offer health coverage.

If an employer offers coverage to all employees working a set number of hours per week that is lower than the § 4980H definition of full-time employees status at 30 hours per week, then the 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) [18] 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.

In addition, these variable positions are likely to be the ones with lower compensation, making coverage affordability more likely to be an issue. Not offering employees full-time positions that had been listed as available to avoid the ESR tax may give rise to employees' claims that they were discriminated against to prevent them from obtaining benefits. [19]

Most employers that have decided to offer coverage to avoid the A Tax can structure their health benefits coverage to avoid imposition of the A Tax either by (a) considering lowering the hours threshold for receiving an offer of coverage, (b) revising staffing or independent contractor relationships, or (c) using staff leasing contracts that permit the employer to consider the offer of coverage by the staff leasing company as its own offer.[20]

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 because the tax is assessable on a monthly basis). In order to do so, 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 its full-time employees to the IRS.[21]

If an employer doesn't identify particular individuals as full-time employees under the ESR regulations or identify which employees are full-time employees in advance of offering them coverage until the IRS assesses either tax under Code § 4980H, then the employer must be able to defend the assessment.

Defending an Assessment. An employer may defend against the A Tax or B Tax by showing that the individual is not a full-time employee or was offered affordable coverage, and may defend against assessment of the B Tax by additionally showing the coverage offered to the individual is affordable and that it provides minimum value. Since the employer isn't 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 that results in the lowest tax liability for the employer provided the employer has the records necessary and otherwise complies with the ESR rules on full-time employee status determination.

In order to do so, the employer must have retained the data (showing hours worked by calendar month; classification/category of the employee; compensation; employee classification under the ESR regulation categories; date of hire in present position; status as full-time, part-time, variable hour or seasonal; dates of commencement and termination of leave and types of leaves; 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 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 for the employees on whom the Service assesses a B Tax will result in the lowest number of full-time employees potentially subject to the B Tax penalty.

If the Service 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 ESR full-time employee status determination rules are never required to be incorporated into a plan document.*

The ESR regulation never requires that the 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 ESR rules do 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 isn't eligible, and ERISA requires plans to be administered in accordance with their documents.[22] The ESR rules also contain alternatives for determining full-time status. Thus, employers using the ESR rules as the basis for eligibility should be careful incorporating by reference the regulations because the alternatives need

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

[18] *Id.*

[19] ERISA § 510; and *Sanders v. Amerimed, Inc.*, 2014 BL 115503, 58 EBC 2483 (S.D. Ohio 2014).

[20] Treas. Reg. § 54.4980H-4(b)(2).

[21] Treas. Reg. § 301.6056-1(j)(2).

[22] ERISA § 402(a)(1).

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to be selected by the employer in its application of the ESR rules. An employer may be able to minimize its potential A Tax and B Tax exposure without adopting all of the ESR 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 ESR rules determine for which employees an assessable A Tax or B Tax can be assessed against the employer and determine that tax on a calendar month basis. Incorporating the ESR rules 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 doesn't 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 doesn't designate and sets up the data collection in advance as described above in item 1, the employer must capture the hours worked and the coverage offered 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 ESR rules later to determine full-time employee status in different ways to find the lowest potential tax for the employer, and also permits the employer to comply with the reporting requirements.

4. *The ESR rules don't 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 for each of the specified categories of employees within 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. These choices aren't required to be specified in a plan document or in any collective bargaining agreement because they are tax rather than eligibility rules.

This gives the employer the flexibility in future years to make changes based on the current economic or business climate. This also permits the employer to test different categories of employees using different lookback/stability periods to determine full-time employee status not only for one year, but from one year to the next. Thus, employers can adapt to changing business environments.[23] 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.[24] For example, when an employee changes employment status during the initial measurement period, there are rules that govern when the B tax won't be assessed if the employee is treated as a full-time employee at the specified times.[25]

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 obtaining 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%) offer of coverage safe harbor, then the offer of coverage must be tested per individual employee to defeat the assessment of the 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.[26]

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.[27] This wouldn't violate the ESR regulations or the Code's nondiscrimination requirements because it's providing preferential coverage to those with the lowest income.

Violation of ESR Rule: The ESR rules would be violated if an employee takes 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. However, if this individual didn't go out to get coverage on the marketplace and obtain a premium tax credit for such coverage, this is a violation of the ESR regulation that may not result in any B Tax.

No Violation of ESR Rule: If the individual who takes leave and returns within 13 weeks and is treated as a new hire is paid at a level above 400% of the federal poverty level[28] no B Tax would result because the individual isn't eligible for the health care premium tax credit and thus couldn't obtain a premium tax credit—if no premium tax credit is obtained, no B Tax could be triggered by such individual.[29]

No Violation of ESR Rule: If the employer offers 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 the employee agrees to take shifts when the employee desires and to drop health coverage from the employer), the 20% pay increase for taking the position without benefits and without a set schedule

[23] Treas. Reg. § 54.4980H-3.
[24] Notice 2014-49.

[25] Treas. Reg. § 54.4980H-3(d)(1)(vii), (d)(3)(vii), (e) and (f).
[26] Code §§ 125 and 105(h) prohibit discrimination in favor of highly-compensated employees, but don't prohibit discrimination in favor of non-highly compensated employees or in favor of certain groups or members of the non-highly compensated employees.
[27] Treas. Reg. § 54.4980H-5(e)(2)(iii) and (iv).
[28] Code § 36B(b)(3)(A)(i).
[29] Code § 4980H(b)(1)(B).

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 potentially trigger the B Tax if their income is low enough and they obtain coverage on the marketplace with a premium tax credit. However, many of the individuals who make this type of election out of benefits do so because they have coverage elsewhere and thus there is no B Tax triggered in those situations. This employee would be counted toward the 95% (or 70% in 2015)[30] threshold as a person who was offered coverage so this is not likely to trigger an A Tax so long as they are offered the opportunity to work in the benefits-eligible position at least once a year. This could potentially 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).[31] 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 ESR rules and the existing nondiscrimination rules for self-insured group health plans don't prohibit an employer from 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 wouldn't be required to extend such subsidization to persons who aren't likely to be eligible for the premium tax credit as long as the subsidization doesn't violate any of the tax law's prohibitions on discrimination, or any other laws' prohibitions on discrimination. For example, Code § § 105 and 125 and § 2716 of the Public Health Service Act all prohibit discrimination only in favor of highly-compensated employees.

Structuring the employees' premiums so that the lowest paid persons are offered the most subsidized coverage may involve increasing overall subsidization or shifting subsidization among groups of employees (provided the change in subsidization for another group isn't 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 ESR regulations says that dependents aging out of the health plan might need to be provided coverage to the end of the month; however, the ESR regulations don't include such a requirement.*

The A Tax is avoided as long as coverage is offered to the safe harbor percentage of full-time employees and their dependents for each day in a month. Not offering a dependent coverage that extends to the last day of the month after the dependent ages out of the plan mid-month doesn't impact whether the safe harbors are satisfied because after coverage ceases for the individual as a dependent, he must be offered COBRA continuation coverage, and thus is offered coverage for every day in that calendar month.[32] There is no requirement that the offer must be at the same price for every day in the month. Furthermore, dropping the dependent who ages out of the plan as of the date the limiting age is attained doesn't leave a dependent uncovered for the remainder of the month, but it leaves a person who used to be a dependent and who is no longer a dependent under the terms of the plan or the law without coverage. Neither the A Tax nor the B Tax is imposed when a person who isn't a dependent isn't offered subsidized coverage when they aren't eligible for coverage as a dependent.

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 only tested currently 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 wouldn't be impacted by the offering of COBRA coverage for a portion of the month at a higher premium.

Thus, the dependent being offered COBRA meets the offer of coverage requirement, and the A Tax and B Tax aren't impacted by a dependent's coverage dropping mid-month upon attaining the limiting age.

7. *If an employer uses the 98% over-reporting rule, it may need to determine which of the employees are full time.*

While the 98% rule 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 either need to know which employees are full-time employees, or the employer must be able to prove it offered coverage to more than 95% of its full-time employees by the design and operation of its plan's eligibility requirements and the demographics of its workforce (e.g., it offers coverage to all employees working 25 or more hours per week on the average and doesn't have any positions working less than 25 hours per week or any contract employees or seasonal employees that overstay the six-month limit on their status).

8. *The ESR tax never states that its rules are the only rules an employer must consider, or that its rules replace or override any of the existing rules governing how an employer offers health benefits to its employees.*

Employers can't operate their health plans solely based on the ESR rules, but must also consider other rules. For example, the ESR rules don't amend or override the cafeteria plan rules or the regulations and guidance defining a change in status that permits mid-year changes in benefit elections. 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.[33]

The ESR rules and the cafeteria plan rules don't fit neatly together and can produce different results. Both rules apply, so employers can't make changes in eligibility or enrollment opportunities mid-year or offers of coverage for the ESR rules that may jeopardize the pretax nature of the benefits under the employer's cafeteria plan. The ESR rules might require coverage to be offered using a determination of eligibility on a basis or at a time that isn't tied to the change in status under the cafeteria plan change in status election rights.[34]

[30] Treas. Reg. § 54.4980H-4(a); 79 Fed. Reg. 8544, 8570 XV.D.1.
[31] Code § 4980H; Code § 36B(b)(3)(A)(i).
[32] Code § 4980B(f)(3)(E).
[33] IRS Notice 2014-55.
[34] Treas. Reg. § 1.125-4.

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While the determination of full-time employee status for under the ESR rules doesn't constitute a change in status under the cafeteria plan rules, there may be a change in status that may be used when an employee becomes a full-time employee under the ESR rules.[35] Recognizing that some changes in eligibility status, if the ESR rules 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.[36]

The ESR regulations also don't override or change other obligations binding an employer regarding offering coverage such as contractual obligations contained in collective bargaining agreements or in corporate transaction documents.

What the Rules Don't Say

It is important to consider what the ESR rules don't say and what this means as employers plan for the ESR tax next year. The above list of what the ESR doesn't say isn't complete or exhaustive, but is an attempt to pick up some key items and highlight the flexibility these items allow to employers.

While employers planning for the ESR tax face many rules, the ultimate objective is only to be able to defend against any tax assessment of the A Tax or B Tax. In order to defend against these tax assessments, the employer must capture and retain certain data: 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 full-time employee status to determine if the employer is an ALE potentially subject to the ESR tax, and isn't for calculating the tax on full-time employees each month under the B Tax.[37]).

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 because the A Tax and B Tax are assessed on a monthly basis. Employers should review each provision providing transition relief to determine exactly what relief each type of transition relief provides and for which year the relief is provided and on which conditions it is provided. There is no ''get out of ESR tax free'' type of relief once an employer is subject to the tax based on its prior calendar year employment statistics.

How the ESR tax 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 ESR tax, as it currently exists, or may exist under future guidance. (The provision for ''predecessor employer'' in the ESR tax is ''reserved'' for future guidance.) While the IRS provided some guidance on changes in determining full-time employee status that may work in a merger or acquisition context,[38] 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 isn't 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 in accordance with state staff leasing laws, or by setting up a clone plan to the seller's plan to continue the employee's coverage, which requires data transfer that must happen at closing to accomplish this in a seamless manner for the employees being transferred).

Employer Shared Responsibility Reporting Clarification

Final reporting forms and instructions were issued in February 2015 for the employer to use in reporting coverage offered and provided in 2015. The IRS had previously released questions and answers on reporting on their website after issuance of the draft forms and instructions during the latter half of 2014. The questions and answers on the reporting of the offers of coverage clarified that the IRS will not impose a penalty for failure to report or incorrect reporting for 2015 offers of coverage and for coverage as long as the employer made a good faith effort to comply. IRS personnel have indicated verbally that a good faith effort does require an attempt to comply.

The general method of reporting offers of coverage is completing the Forms 1094-C (transmittal form) and 1095-C for offers of coverage. An employer with a self-insured plan may also report coverage provided to employees on such forms, but if the employer provides coverage to non-employees (e.g., COBRA qualified beneficiaries or retirees) such coverage provided should be reported on Forms 1094-B and 1095-B.[39]

There are two alternative or simplified methods of reporting—offers of coverage certification of qualifying offers and over-reporting. The questions and answers and final instructions clarify there must be only one Form 1095-C filed by the employer for each full-time employee. IRS personnel have stated verbally that employers planning to use the 98% rule to over- report in 2015, must satisfy the 98% requirement in each month in 2015. The final instructions confirm the 98% rule must be met for all months in the year and provide clarification on the alternate reporting.

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, but may report this for employees on the Form 1094-C and 1095-C. The forms 1094-B and 1095-B reporting coverage provided by a self-insured employer may be used for reporting coverage provided to non-employees such as COBRA quali-

[35] Treas. Reg. § 1.125-4; IRS Notice 2014-55.
[36] Notice 2014-55.
[37] Treas.Reg. § 54.4980H-3(c)(3) and (a).
[38] IRS Notice 2014-49.
[39] Final Instructions to Forms 1094-C and 1095-C issued February 2015.

fying beneficiaries. Thus a self-insured plan maintained by an employer as long as it provides COBRA coverage to at least one non-employee or COBRA beneficiary may file both Forms 1094-C and 1095-C to report coverage offered and provided to employees and file Forms 1094-B and 1095-B to report the coverage provided to non-employees.

Conclusion

While some employers may choose to change their group health plan's eligibility rules to use the ESR rules in 2015 and subsequent years out of an abundance of caution, an employer is able to *not* use the ESR rules as its eligibility rules and *still* minimize its exposure to tax assessments and comply with the reporting requirements using the over-reporting (or 98%) method and the A Tax safe harbor.

However, an employer choosing not to use ESR rules as its eligibility rules must capture the data necessary to defend against the A Tax and B Tax assessments and to comply with the reporting requirements. An employer can protect itself from both taxes as long as it carefully considers its workforce, demographics, compensation and benefit structure and other restrictions on itself, and provided that it 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 systems or whether they should design their plan eligibility broadly enough to capture certain employees. For employees who exceed the 30-hour-per-week threshold on a frequent enough basis to trigger full-time status, the employer must satisfy the 95% (70% in 2015) threshold for the safe harbor from the A Tax and offer coverage at least once each calendar year to individuals it determines are likely to be full-time employees. The employer must then ensure that its systems capture the data necessary to determine which employees are full-time under the various testing methods for both the A and B Tax.

The employer can then defend against the ESR tax 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, such as the rate of pay or federal poverty level methods. 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 ESR 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 the employer deciding where to best allocate the funds.

To minimize the tax risk under the ESR rules, an employer must analyze the different calculation methods in the rules for determining who is a full-time employee. The employer must also determine what affordable coverage is and consider the best way to allocate its limited resources for health care coverage. The ESR rules require consideration of different mathematical variations on two fundamental concepts to determine the best way to allocate an employer's HR resources. Those concepts involve determining the allocation of resources, which is a question of paying for tax and reporting or paying for coverage, administration and reporting.

When one steps back and considers the bigger picture of the ESR rules and what they don't require, one can be liberated from the extraordinarily detailed requirements of determining full-time employee status under every aspect of the ESR rules. Instead, one can focus on the best use of the employer's HR or benefits department budget. When the ESR rules are viewed as what they are—rules for tax assessment and not rules for eligibility, an employer can decide to allocate its resources in the way that best suits its needs. It can do this by designing health plan eligibility considering the 30-hours-per-week-full-time employee status threshold, but without being bound by every detail of the ESR rules determination methods. It can instead focus on capturing the data necessary to test after the end of the calendar year using the different methods for various categories of employees, and can avoid programming and reprogramming eligibility each year, as well as communicating the complex rules to employees.

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