On February 10, 2014 final regulations under the Employer Shared Responsibility provisions of the Affordable Care Act (ACA) were issued. Part of those final regulations included clarifications on the affordability safe harbor definitions under this provision.

**Background**

Generally under Employer Shared Responsibility provisions, no penalty can be imposed on a large employer who offers group health plan coverage to at least 95% of full time employees and dependents, if that coverage meets ACA requirements for “affordability” and “minimum value.” (Full-time is defined as working on average at least 30 hours per week or 130 hours per month.)

The final regulations made several changes that apply for 2015 only. A large employer is defined as an employer with at least 100 full time employees or full time equivalents. Employers with 50-99 full time employees or equivalents get a one-year delay for compliance. Additionally, a large employer will not be subject to potential penalties if it offers group health plan coverage to at least 70% (rather than 95%) of all full time employees, and dependents.

**Definition of Key Terms**

**Affordability:** Coverage is “affordable” if no full time employee is required to pay more than 9.5% of his/her “household income” for self-only coverage under the employer’s lowest-cost option that provides minimum value.

“Household income” was initially defined in guidance as the employee’s income in Box 1 on Form W-2. However, subsequent regulations (issued 12/28/2012) established three “safe harbors” an employer can opt to use to comply with the Affordability test. See below for a detailed explanation of the three safe harbors.

**Also note** that the Affordability test is based on the employee cost for self-only coverage **even if** the employee in fact has a family and needs family coverage. This point is significant because it affects family members’ eligibility for a subsidy if they buy insurance in the Exchange/Marketplace. If employer-provided coverage is available — **even if not affordable** — family members will not be eligible for a subsidy as long as single coverage provided meets affordability.

**Minimum Value:** Coverage meets “minimum value” requirements if the plan pays at least 60% of the actuarial value of benefits covered under the plan. This means that on average a plan participant pays — via deductibles, coinsurance, copayments and other out-of-pocket amounts — not more than 40% of the actuarial value of benefits under the plan. Plans can use the Minimum Value calculator or Actuarial Value calculator on the HHS website to determine their actuarial value. [www.cms.gov/ccio/resources/...and.../mv-calculator-final-4-11-2013.xlsm] Insured plans should ask the carrier what the actuarial value is for a particular policy. Based on statements by HHS (in the preamble to the proposed regulations on Essential Health Benefits and Actuarial Value), most group health plans currently meet the 60% actuarial value...
requirement. An example of an employer plan that probably would not meet the 60% requirement is a “mini-med” or catastrophic plan.

The Three Affordability Safe Harbors
The Employer Shared Responsibility final regulations include, among other things, clarification of how the three affordability safe harbor methods apply. Compliance with a safe harbor means that an employer will be deemed compliant with the law and cannot be subject to penalties. Use of any of the safe harbors is optional, and an employer may apply different safe harbors for any reasonable category of employees provided it applies the safe harbor on a uniform and consistent basis for all employees in a particular category.

The final regulations clarify that reasonable categories generally include specified job categories, nature of compensation (e.g., salaried or hourly), geographic locations, similar bona fide business criteria. However, listing employees by name would not be a reasonable category.

Thus, when trying to ensure that the employee cost for self-only coverage under the employer’s lowest-cost option is not more than 9.5% of any full time employee income, the three optional safe harbors are:

- W-2 income
- Rate of Pay (Monthly)
- Federal Poverty Line

Additional information about each Affordability Safe Harbor is detailed below

W-2 Safe Harbor
This method allows the employer to use each employee’s W-2 income (Box 1) from the current year to determine affordability

**How to Calculate:**

- When using this method, the W-2 Form for the current year is used. That is, the total W-2 compensation for 2015 (from a particular employer) determines the maximum monthly amount that employer can charge the employee for self-only coverage. This means the employer probably must set the maximum monthly contribution based on the monthly W-2 amount.
- The final regulations provide that the employee’s required contribution during the year must remain a consistent dollar amount or a consistent percentage of all Form W-2 wages during the year (the calendar year, or the plan year for non-calendar year plans). An employer is not permitted to make discretionary adjustments for a pay period, nor can an employer “frontload” the monthly employee cost and then reduce it late in the year. An employer who uses the W-2 safe harbor may wish to set each employee’s cost for self-only coverage at 9.5% of the employee’s W-2 wages for the month, but also set a maximum monthly amount. This will ensure the employee contribution meets “affordability” for lower-paid employees and will also ensure that higher-paid employees are not charged excessive monthly amounts. For example, an employer might want to set the employee cost for self-only coverage as “9.5% of each eligible employee’s W-2 wages, not to exceed $150 per month.”
- To calculate affordability for full time employees not employed the full year, multiply the W-2 wages for the calendar year by a fraction equal to the months for which coverage was offered to the employee over the months the employee was employed (a month is counted if offered or employed at least one day during a calendar month). For example, an employee worked eight months of a calendar year, and was offered coverage during five of those months. At the end of the year, the
employee received a Form W-2 reflecting wages of $24,000. To calculate, multiply $24,000 by 5/8 to get adjusted W-2 wages of $15,000. Then calculate 9.5% of same.

**Disadvantages:**
- Box 1 income does not include pre-tax contributions for 401(k) or cafeteria plans, so if an employee makes these pre-tax contributions this will reduce the maximum affordable amount.
- This is calculated on an employee-by-employee basis, and will have to be calculated each month if W-2 income varies. This can be administratively burdensome and time consuming.
- An employer might not want to use the W-2 method if it has variable hour or seasonal employees, or if it has employees whose hours of service or compensation vary over the course of the year.

**Advantages:**
- The W-2 income safe harbor generally will result in a higher monthly premium “affordable” amount. This is because the W-2 method includes all hours the employee actually worked and hours for which no work was performed but the employee was paid or entitled to payment (e.g., paid holidays and vacation, paid leave and disability). It is not limited to 130 hours/month, as is the Rate of Pay safe harbor below.
- An employer might want to use the W-2 method if it has a stable workforce comprised mostly of regular full-time employees who work 40 hours per week and whose compensation is unlikely to decrease during the year.

**The maximum amount:**
Based on $8/hour and 40 hours/week and 52 weeks/year, the maximum employee contribution (for self-only coverage) per month would be $131. It could be more if an employee worked overtime but less if an employee made pre-tax 401(k) or cafeteria plan contributions.

**Rate of Pay (Monthly) Safe Harbor**
This design-based method allows the employer to calculate affordability on a monthly basis.

**How to Calculate:**
- For hourly employees, 130 hours multiplied by the employee’s hourly rate as of the first day of the plan year or the lowest hourly rate of pay during the calendar month.
- For non-hourly employees, use the employee’s monthly salary as of the first day of the plan year (regardless of hours on which is based).
- An employer can use the “rate-of-pay” safe harbor even if the employer reduces an employee’s hourly pay rate during the plan year, but the rate-of-pay safe harbor will apply separately for each month. This will result in a lower maximum “affordable” rate for those months an employee’s hourly rate has been reduced. Note that if an employer uses the rate of pay of the lowest-paid employee and multiplies this by 9.5%, the resulting monthly amount will meet the test for all employees.

**Disadvantages:**
- The employer can only multiply the hourly amount by 130 hours per month, even if employees actually work more hours.

**Advantages:**
- Although technically this is calculated on an employee-by-employee basis, it can also be a “fail-safe” design-based safe harbor because if this Affordability test is met for the lowest-paid employee, then it will also be met for all other employees.
• This affordability calculation will apply even if an employee works fewer hours or is on leave during some months. For example, if a full-time hourly employee earns $10 per hour in a calendar month (and earned at least $10 per hour at the beginning of the year), coverage is affordable if the employee cost for employee-only coverage is not more than 9.5% of $10 x 130 hours (this would equal $123.50), even if the employee has a significant amount of unpaid leave or otherwise reduced hours in one or more calendar months.

• The employer can calculate the maximum amount for affordability as of the beginning of the plan year (and on a monthly basis if hourly rate is reduced during the year), and need not wait until after the end of the year to determine it.

**The maximum amount:**

Based on $8/hour and 130 hours per month, the maximum employee contribution (for self-only coverage) per month would be $98.80. (Based on $7.25/hour, the federal minimum wage, the maximum monthly amount would be only $89.54.)

**Federal Poverty Line Safe Harbor**

This method allows the employer to use 100% of the Federal Poverty Line (FPL) income (for a household size of one) to determine affordability. For 2014, this amount is $11,670.00.

**How to Calculate:**

• There is no calculation other than taking the FPL figure, dividing it by 12, and calculating 9.5% of that figure. For example, for 2014 9.5% of $11,670.00 (the FPL for one person) is $92.39/month. An employer can elect to use the FPL rate in effect six months prior to the start of the plan year, rather than at the start of the plan year.

**Disadvantage:**

• **The Maximum Amount:** This method typically provides the lowest threshold allowed for the monthly premium. For example, in 2014 100% of FPL for one person is $11,670.00, so the maximum employee contribution (for self-only coverage) per month would be only $92.39. Other methods generally allow a higher monthly premium charge.

**Advantages:**

• This is not a separate calculation for each employee. It is a “fail-safe” safe harbor that will apply even if the amount is less than a particular employee’s actual income for the month or year. An employer use uses this safe harbor will always meet the affordability standard each month.

• This safe harbor may be most useful for employers who use the look-back measurement period to determine if variable hour or seasonal employees have full-time status. Employers whose lowest paid employee is a “moving target” may have to check affordability each month throughout year unless they use this “100% of FPL” method.

• This safe harbor may also be useful to employers with employees whose hours of service are higher earlier in the year and are reduced later in the year.

• The final regulations allow an employer to use the FPL rate in effect six months prior to the start of the plan year, rather than at the start of the plan year. Employers generally set rates three to six months before the start of the plan year.
Affordability Chart

The “Affordability Chart” below shows the maximum monthly amounts an employer can charge an employee—at various hourly rates of pay and hours worked—for self-only coverage under an “Affordable” employer group health plan. Note that $7.25/hour is the current federal minimum wage. Many states have higher minimum wage amounts.

Affordability Chart

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<th>Hourly Rate</th>
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<th>Max. Monthly EE Cost for EE-Only Coverage</th>
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<td>$1,108.65</td>
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</tr>
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</table>

* California minimum wage increases to $9/hour as of July 1, 2014.

How to use this chart:
- If you have employees who are paid $7.25/hour and work 30 hours/week, your plan will meet the “monthly rate of pay” affordability test if such employees are not charged more than $89.54/month for self-only coverage.
- If you have employees who are paid $7.25/hour but they all work 40 hours/week, your plan will meet the W-2 affordability test if such employees are not charged more than $119.38/month for self-only coverage.
- The last row of the chart lists the amount that is 100% of the 2014 Federal Poverty Level (FPL) for a family of one. (FPL amounts vary by household size. Also, FPL amounts are higher for Alaska and Hawaii than for the 48 contiguous states.)