AFFORDABILITY under the Employer Shared Responsibility Provisions of the ACA

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Large employers may be subject to penalties under the Employer Shared Responsibility provisions of the Affordable Care Act (ACA) if they do not offer group health coverage that is "affordable" and provides "minimum value" to substantially all employees and dependents. There are several safe harbor definitions of affordability. Final regulations issued February 10, 2014 included clarifications on these safe harbors. This article details each of the safe harbors and provides illustrative examples. An Affordability Chart at the end details the maximum monthly dollar amount for various hourly rates and annual compensation levels.

Background

Under Employer Shared Responsibility provisions of the Affordable Care Act (ACA), a "large" employer may be subject to penalties under IRC section 4980H(a) if it does not offer group health plan coverage to substantially all full time employees and dependents. If an employer does offer coverage but it does not meet ACA requirements for "affordability" and "minimum value," the employer may be subject to penalties under IRC section 4980H(b).

Generally, a "large" employer is one who employed on average at least 50 full time employees or full time equivalents in the prior calendar year. For 2015 only, however, the final regulations define a large employer as an employer who employed on average at least 100 full time employees or full time equivalents in 2014. Thus, employers with 50-99 full-time employees or equivalents get a one-year delay for compliance as long as they meet certification requirements. Additionally, for 2015 a large employer will not be subject to potential penalties if it offers group health plan coverage to at least 70% of all full time employees and dependents. After 2015 that threshold percentage increases to 95%. For 2014 and beyond, "full-time" is defined as working on average at least 30 hours per week or 130 hours per month.

Definition of Key Terms

Affordability: Coverage is "affordable" for each full-time employee for whom the cost of self-only coverage is not more than 9.5% of his/her "household income" under the employer's lowest-cost option that is actually available to that employee and that provides at least minimum value. (For 2015, Revenue Procedure 2014-37 provides that this amount is increased to 9.56%; however, some attorneys disagree with the IRS and believe the 9.5% is a fixed percent and is not subject to the indexing adjustments under the ACA. Employers should follow advice from their legal counsel or just continue to use 9.5% as the affordability threshold pending further clarification.)

"Household income" was initially defined in guidance as the employee's income in Box 1 on Form W-2. However, subsequent guidance established two additional "safe harbors" an employer can opt to use to comply with the Affordability test. The final regulations continue these three safe harbors. See below for a detailed explanation of the three safe harbors and how 9.5% is calculated under each.

Additional note: 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 for a family* —family members will not be eligible for a subsidy as long as single coverage provided meets the Affordability requirement.

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 not more than 40%, via deductibles, coinsurance, copayments and other out-of-pocket amounts (but not including the participant's monthly premium payments). Plans can use the Minimum Value calculator or Actuarial Value calculator on the HHS website to determine their actuarial value. The AV Calculator is at: http://www.cms.gov/CCIIO/Resources/Regulations-and-Guidance/Downloads/av-calculator-final.xlsm. The MV Calculator is at: http://www.cms.gov/cciio/resources/regulations-and-guidance/downloads/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.

The three optional safe harbors an employer can use to ensure that the employee cost for self-only coverage under the employer's lowest-cost option (actually available to that employee) is not more than 9.5% of any full-time employee's income are:

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

A planning tool that is sometimes referred to as a "pseudo" safe harbor is the "138% of Federal Poverty Line" test. Additional information about each Affordability Safe Harbor (and the pseudo safe harbor) is detailed below.

Use of any of the safe harbors is optional, but the election to use them should be documented. One reason for this is because the final regulations on Code section 6056 Information Reporting allow a large employer to use a simplified reporting method (called the "Qualifying Offers" method) if it meets specific requirements. One of these requirements is that the employer must use the Federal Poverty Line safe harbor to set the affordability threshold for those full-time employees for whom it reports using this simplified method. Additionally, the draft form 1095-C (one of the forms large employers must use for 6056 Information Reporting) requires employers to input an indicator code (Part II, line 16) listing the applicable safe harbor, if applicable).

If a large employer is not going to use the simplified reporting method (so is not required to use the Federal Poverty Line safe harbor) the 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, and similar bona fide business criteria. However, listing employees by name would not be a reasonable category.

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:

- Each employee's annual contribution for self-only coverage cannot exceed that employee's W-2 (Box 1) income for the current year. Since this amount will not be known until the end of the year, an employer who uses this method must estimate what each employee's annual W-2 amount will be based on what the employee's compensation is as of January 1 of each year. If an employee's compensation decreases during the year (e.g., due to reduced hours or to a reduced hourly rate), the employer will have to reduce the employee's contribution at that time if the contribution was initially set at or just below the affordability threshold.
- 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 later in the year. One possible strategy for an employer who uses the W-2 safe harbor is 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." This strategy will complicate payroll administration, however.
- 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 may have to be changed before the end of the year if actual W-2 income varies from the amount projected at the beginning of the year. 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.
- If an employer uses the Look-Back Measurement Method and the W-2 safe harbor, and employees with coverage during the Stability Period are working significantly fewer hours than during the Measurement Period, the employer may have to reduce the employee cost for employee-only coverage in order to meet the W-2 Affordability test. For example, if the Measurement Period is 2014 and the Stability Period is 2015, and a full-time hourly employee earned $10/ hour in 2014 and

worked on average 40 hours per week, but during 2015 that employee averages only 20 hours per week (still earning $10/hour), coverage during 2015 is affordable only if it is not more than 9.5% of the employee's W-2 income in 2015. This would be half as much as the 2014 W-2 income.

- An employer cannot use the W-2 safe harbor for those employees for whom the employer will use the "qualifying offers" simplified method of information reporting (under Code section 6056). Only the FPL safe harbor qualifies for the simplified method under large employer reporting provisions

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.

Example of the Maximum Amount:

Assume that as of January 1, 2015, an employee earns $8/hour and is regularly scheduled to work 40 hours/week and 52 weeks/year (or 50 weeks/year plus two weeks of paid vacation). The employer doesn't know until the end of 2015 whether the employee actually will work these hours at this rate of pay.
If the employee does, indeed, work as scheduled during 2015, the maximum employee contribution (for self-only coverage) per month would be $131.73. This is based on annual compensation of $16,640, of which 9.5% would be $1,580.80, and one-twelfth of that would be $131.73.

As noted, however, the Box 1 amount on the W-2 could actually end up to be more if an employee worked overtime or if the pay rate increased during the year, but less if an employee made pre-tax 401(k) or cafeteria plan contributions. If the employee's monthly contribution in this example was set at $131 per month and the actual W-2 amount was higher than projected, the affordability threshold would be higher, so $131 per month would be fine. However, if the actual W-2 amount was only $15,000, the maximum annual employee contributions could not be more than $1,425 (9.5% x $15,000), so the coverage would not be affordable for this employee. If the employee declined coverage and instead went to the Exchange, the employee would be eligible for a subsidy and the employer would be subject to a penalty of $250 per month for this employee.

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 each 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 rate of pay during the plan year, but the rate-of-pay safe harbor will apply separately for each month. This means if the rate of pay is reduced in a following month, affordability needs to be recalculated based on the new lower rate of pay. 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.
- Note an employer needs to recalculate affordability during the plan year for any months in which **rate of pay** is reduced. However, an employer need not recalculate under this method if the employer reduces monthly **hours** an employee works or if an employee has periods of unpaid leave).

Disadvantages:
- The employer can only multiply the hourly amount by 130 hours per month, even if employees actually work more hours.
- An employer cannot use the Rate of Pay safe harbor for those employees for whom the employer will use the "qualifying offers" simplified method of information reporting (under Code section 6056). Only the FPL safe harbor qualifies for the simplified method under large employer reporting provisions.

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 each month, 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 (as required under W-2 method).

Example of 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. Based on $9/hour, the California minimum wage as of July 1, 2014, the maximum monthly amount would be $111.15.)

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.

How to Calculate:
- There is no calculation other than taking the FPL amount, dividing it by 12, and calculating 9.5% of that amount. For example, for 2014, 9.5% of $11,670 (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, as noted above, in 2014 the maximum employee contribution (for

self-only coverage) per month would be only $92.39 using this safe h arbor. Other methods 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 who 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 Method and have numerous variable hour or seasonal employees. Employers whose lowest paid employee is a “moving target” may have to check affordability each month throughout the 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, and the FPL rate may be lower 6 months prior than at the start of the plan year.
- An employer who will use the “qualifying offers” simplified method of information reporting (under Code section 6056) <u>must</u> use the FPL safe harbor for those employees for whom the employer will use the “qualifying offers” method.

An Example of the Maximum Amount:
As noted above, the maximum amount for 2014 is $92.39 per month.

“Pseudo” Safe Harbor: 138% of Federal Poverty Line

This method is not in the regulations, and it is not an official safe harbor. . Using this pseudo safe harbor (and setting the employee cost for self-only coverage equal to 138% of the FPL) is really just a planning tool for a large employer who is trying to estimate its potential penalty liability under IRC section 4980H (the penalty for not meeting the Employer Shared Responsibility). Individuals with household incomes at or below 138% of the Federal Poverty Line (FPL) will qualify for Medicaid (Medi-Cal in California) in those states that have implemented the Medicaid expansion. Thus, such individuals will not qualify for a subsidy if they go to the Exchange/Marketplace, because they will be enrolled in Medicaid/Medi-Cal instead. Large employers are subject to a penalty only if a full-time employee buys insurance in an Exchange and qualifies for a subsidy. Using this “pseudo” safe harbor, an employer who offers coverage to at least 70% of full-time employees in 2015 (95% after 2015) could take a chance that it would not be subject to a 4980H(b) penalty for any employees if it sets the employee cost for self-only coverage equal to 9.5% of 138% of the FPL for one. For 2014 the annual amount would be $16,105 and the maximum monthly employee cost for employee-only coverage would be $127.50.

As noted previously, one of the forms large employers must use for 6056 Information Reporting requires employers to input an indicator code listing the applicable safe harbor, if applicable (Form 1095-C , Part II, line 16). The pseudo safe harbor is not one of the official safe harbors so is not included in the indicator codes. A large employer who uses 138% of the FPL for planning purposes would also be required to list one (or more) of the official safe harbors on the Form 1095-C, if applicable. (The IRS has not yet issued Instructions for the Form 1095-C, so it is not known exactly when an indicator code for the safe harbor would have to be listed and when it would not be applicable.) For more information about Large Employer Reporting provisions, please see our March and July 2014 articles entitled: *Information Reporting for Large Employers: Final Regulations*, and *IRS Releases Draft Forms for Employer Reporting*

How to Calculate:

- There is no calculation other than taking 138% of FPL, dividing it by 12, and calculating 9.5% of that figure. As noted above, for 2014 the annual amount is $16,105, and 9.5% of this is $127.50 per month.

Disadvantage:

- If an employee's income from the employer is less than 138% of the FPL but the employee's household income is between 138% and 400% of the FPL, the employee might buy insurance in the Exchange and qualify for a subsidy. This would result in a penalty for the employer, if the employer set the monthly employee cost for self-only coverage at $127.50.
- This pseudo safe harbor is not applicable in states that have not implemented the Medicaid expansion. Employers should check each state in which they have employees.

Advantages:

- There is not a separate calculation for each employee. It is a pseudo "fail-safe" safe harbor that will apply for all employees as long as the employee's household income is not more than 138% of the FPL, in states that have implemented the Medicaid expansion.

Affordability Chart

See the "Affordability Chart" on the following page.

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 (and some cities) have higher minimum wage amounts.

Hourly Rate	Hours/ Week	Annual Comp	9.5% of Comp.	Max. Monthly EE Cost for EE-Only Coverage
$7.25	30	$11,310	$1,074.45	$89.54
$7.25	40	$15,080	$1,432.60	$119.38
$8	30	$12,480	$1,185.60	$98.80
$8	40	$16,640	$1,580.80	$131.73
$9*	30	$14,040	$1,333.80	$111.15
$9	40	$18,720	$1,778.40	$148.20
$10	30	$15,600	$1,482.00	$123.50
$15	30	$23,400	$2,223.00	$185.25
2014 100% FPL for 1	N/A	$11,670	$1,108.65	$92.39
2014 138% FLP for 1	N/A	$16,105	$1,529.98	$127.50

* California minimum wage increased to $9/hour as of July 1, 2014, and to $10/hour as of Jan 1, 2016

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 two rows of the chart lists amounts that are based on the Federal Poverty Level (FPL) for a family of one for 2014. (FPL amounts vary by household size. Also, FPL amounts are higher for Alaska and Hawaii than for the 48 contiguous states.)

