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Affordability Consideration

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It is important to understand whether coverage offered under an employer-sponsored group health plan is "affordable" for compliance with the employer shared responsibility rules under Section 4980H and for purposes of individual eligibility for tax subsidies through a public exchange. When setting plan contribution rates, employers should consider the IRS employer affordability safe harbors, the various elements that play into the determination of the employee contribution, and the penalties associated with not offering affordable coverage.

Background

Applicable large employers—those with 50 or more full-time equivalents (FTEs)—are required to comply with the employer shared responsibility rules under Section 4980H (also known as the "employer mandate"). To avoid potential penalties, employers are required to offer minimum value, affordable coverage to substantially all full-time employees and their dependent children. In addition, individuals who are offered (or eligible for) minimum value, affordable coverage under an employer-sponsored group health plan are not eligible for a tax subsidy when purchasing individual health insurance through a public exchange.

One source of confusion is that there are two different types of affordability that an employer needs to consider. First is the definition of "affordable" that determines whether an individual is eligible for a subsidy when purchasing individual health insurance through a public exchange. Second is the definition of "affordable" under the employer safe harbors that is used to protect the employer from the 4980H(b) penalty in certain circumstances.

In general, for purposes of an individual's subsidy eligibility, coverage is "affordable" if the employee's required contribution for employee-only (single) coverage does not exceed 9.56% of the employee's household income. However, for purposes of the employer safe harbors, the coverage is affordable if the employee's required contribution for single coverage is less than 9.5% (not 9.56%) of one of three different standards: the employee's W-2 wages, the employee's hourly rate of pay, or the federal poverty level (FPL).

Affordability Safe Harbors

An employer is unlikely to know the employee's household income, so the IRS provided three employer affordability safe harbors. When setting employer contribution rates, employers have the option to use one of three affordability safe harbors to provide more predictability in regard to whether the coverage will be considered affordable. So long as minimum value coverage is affordable under one of the three recognized safe harbors, the employer will be considered in compliance for purposes of avoiding a potential penalty under 4980H(b). Note that the use of the employer safe harbor does not change an individual's possible eligibility for subsidies.

An employer may choose to apply any of the safe harbors for any reasonable category of employees, provided it does so on a uniform and consistent basis for all employees in a category. The regulations provide that reasonable categories for this purpose generally include specified job categories, nature of compensation (hourly or salary), geographic location, and similar bona fide business criteria. Each safe harbor is described below:

- Rate of Pay Safe Harbor –
  - For an hourly employee, the employer uses an assumed rate of 130 hours per calendar month multiplied by an hourly employee's rate of pay, regardless of whether the employee actually works more or less than 130 hours during a calendar month. The employee's monthly contribution is affordable if it is equal to or lower than 9.5% of this computed monthly wage estimate, regardless of the number of hours the person actually works or is paid in the month. Therefore, this particular safe harbor protects the employer even in

situations in which the employee's hours may be less than full-time and the employer remains obligated to continue offering coverage during the stability period.

- For a non-hourly employee, the coverage is treated as affordable if the employee's required contribution does not exceed 9.5% of the employee's monthly salary as of the first day of the coverage period (instead of 130 multiplied by the hourly rate of pay)—But, if the monthly salary is reduced, including due to a reduction in work hours, the safe harbor is not available.
- NOTE – this safe harbor cannot be used for tipped employees or for employees who are compensated solely on the basis of commissions.
- EXAMPLE – Employer has full-time employees paid $9/hour and up. So long as employee contributions for the lowest cost minimum value plan do not exceed $111.15 per month (130 X $9 X 9.5%), the coverage will be considered affordable.

- <u>Federal Poverty Line Safe Harbor</u> –
  - Coverage offered to an employee is affordable if the employee's cost for self-only coverage does not exceed 9.5% of the federal poverty line (FPL) for a single individual (i.e. approx. $93/month in the contiguous United States for 2015).
  - "Federal Poverty Line" refers to any of the poverty guidelines (updated periodically in the Federal Register by the Secretary of Health and Human Services) in effect within six months before the first day of the plan year of the applicable large employer member's health plan.
  - The applicable federal poverty line is based on the state in which the employee is employed.
- <u>Form W-2 Safe Harbor</u> –
  - Application of this safe harbor is determined after the end of the calendar year, taking into account the employee's annual W-2 wages (as reported in Box 1) and the employee contribution for the full calendar year for the employer's lowest-cost self-only coverage that provides minimum value. So, for example, the employer would have to base affordability on an estimate for the year and then determine whether it met the affordability safe harbor for 2015 for an employee by looking at that employee's W-2 wages for 2015 (as reported in Box 1) and comparing 9.5% of that amount to the employee's required 2015 contribution.
  - To use this method, an employee's required contribution must remain a consistent amount or a consistent percentage of all Form W-2 wages during the year.
  - Box 1 is used to report taxable wages, bonuses, tips, and other compensation paid by the employer, as defined in Code § 3401(a). It does not include non-taxable employee benefits, such as pre-tax contributions to a 401(k) plan or pre-tax cafeteria plan salary reductions.
  - *EXAMPLE 1* – Employee is full-time January through December and is offered minimum value coverage that costs the employee $100 per month for single coverage ($1,200 for the year). This coverage will be considered affordable for any employees that have Box 1 W-2 wages of $12,632 per year or more ($1,200 / 9.5%).
  - *EXAMPLE 2* – Employer expects that all full-time employees will have at least $15,000 or more reported in Box 1 during the year. So long as the employee contributions for the lowest cost minimum value plan do not exceed $1,425 for the year ($15,000 X 9.5%), the coverage will be considered affordable for those considered full-time all 12 months.

Note that although the percentage of household income for purposes of affordability was raised to 9.56% for 2015 and will continue to be adjusted from year to year, when using any of the affordability safe harbors, employers must continue to use the 9.5% standard specified in the regulations because that percentage has not been updated.

Affordable and Not Affordable at the Same Time!

Subsidy eligibility will always be based on household income. However, if an individual qualifies for a tax subsidy because the employee contribution is deemed unaffordable using household income, but the employer can show that the coverage is affordable using one of the three safe harbor methods mentioned above, the employer will not be liable for a penalty under 4980H(b).

Consider the following example:

- Employer determines that the lowest rate of pay for hourly employees is $10 per hour. Using the rate of pay safe harbor, the employer decides to set employee contribution for single coverage at $117.00.
  - o 130 hours x $10/hr = $1,300
  - o $1,300 x 9.5% = $123.50
- One of the employer's full-time employees earns about $1,300 per month, but has to make a $300 per month alimony payment.
  - o Household income for subsidy purposes is based on an individual's household adjusted gross income (AGI), and alimony payments are an "above the line" deduction that reduces an individual's AGI.
  - o Consequently, this individual's monthly household income equals $1,000 and the employee's required contribution for single coverage ($123.50) equals 12.35% of household income.
  - o This employee would qualify for a subsidy when purchasing individual health insurance through a public exchange, but the employer would face no liability under 4980H(b) due to meeting the rate of pay safe harbor.

Determining Employee Contributions

In addition to the amount the employee is required to contribute toward the cost of employee-only (single) coverage, whether handled on a pre-tax or after-tax basis, several other employer provided benefits may affect what is considered the employee contribution for purposes of the affordability calculation as set forth below:

- HSAs – Contributions to a health savings account (HSA) do not affect affordability.
- HRAs – Contributions to a health reimbursement account (HRA) may need to be considered for affordability purposes. If the HRA contributions are restricted only to cost-sharing (i.e. deductible, copays, coinsurance), they count towards determining minimum value and will increase the value of the plan. On the other hand, if the HRA contributions can be used for premiums, they would be included when determining whether the coverage is affordable.
- Flex Credits – In general, although guidance is not as clear as we'd like, it appears that flex credits that can be used for medical coverage or be taken as cash must be considered employee contributions for purposes of calculating affordability.
- Opt-Out Credits and Incentives – If the employee has the option to either receive coverage or receive an amount as taxable cash (an opt-out or waiver incentive), this cash option may need to be considered for purposes of affordability. If the credit is available to any employee who waives coverage, the opt-out incentive should be used in calculating affordability for all eligible employees.
  - o For example, when the employee cost for health coverage is $75 per month, but there is an opt-out credit of $50 per month if coverage is waived, the employee contribution for affordability purposes is $125 ($75 + $50).

- o However, if the opt-out credit is limited only to employees who show proof of other group insurance, then the credit would be considered only for those employees who opt out and provide this certification. In this scenario, there is little or no 4980H(b) risk to the employer because the opt-out would be provided only to employees who have other group coverage. Since these employees have other group coverage, they would be ineligible for subsidies through a public exchange.

- Wellness Incentives – Affordability is determined assuming the individual fails to satisfy any wellness requirements, UNLESS it is tobacco-related. For example:
  - o Required employee contribution for the month is $200 and potential wellness incentive (not tobacco-related) reduces the cost to $150; coverage is "affordable" so long as the $200 (not $150) does not exceed 9.56% of the employee's household income.
  - o Required employee contribution for the month is $200 and the potential wellness incentive (tobacco-related) reduces the cost to $130; coverage is "affordable" so long as $130 (not $200) does not exceed 9.56% of the employee's household income.

Setting Employer Contributions

It is not always financially advantageous to the employer to ensure that the coverage offered is affordable to ALL full-time employees. Employers should consider the $250/month cost of the penalty for a full-time employee receiving a subsidy. Often the employer contribution for employees who enroll in the employer's plan is more than the employer would be required to pay as a penalty under 4980H(b). Furthermore, the 4980H(b) penalty applies only to those full-time employees who are actually enrolled through a public exchange and qualify for a tax subsidy.

Additionally, it is important to understand that there is nothing under 4980H rules that requires a uniform contribution rate across all categories of employees; rather, affordability is considered on an employee-by-employee basis. Therefore, the employer could choose to contribute differently to different categories of employees (i.e. a percentage of salary). However, anytime the employer sets different contribution rates for different categories of employees, nondiscrimination rules, which generally prohibit providing benefits in a way that favors the highly compensated individuals, must be considered.

Summary

When applicable large employers set employer contributions for health coverage, there are many variables that may affect the strategy chosen. The IRS has simplified things a bit by allowing employers to use one of three employer affordability safe harbors that provide a bit more predictability in regard to potential penalties as opposed to having to guess at an employee's household income. Employers will also need to consider the various other benefits and incentives offered that may affect what is considered to be the employee contribution amount for purposes of calculating affordability. And finally, it is important to weigh the risk of a potential penalty of $250 per month under 4980H(b) for some employees versus choosing to set the employer contribution at a higher rate for all employees.

As always, should you have any questions, please contact your Parker, Smith & Feek Benefits Team.

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