Pay or Play Penalty—Affordability Safe Harbors

Provided by GCG Financial, Inc.

Quick Fact

Applicable Large Employers with 100 or more full-time equivalent employees must offer affordable coverage in 2015 or face shared responsibility penalties. Employers with 50 to 99 full-time equivalent employees are not required to comply until 2016.

The Affordable Care Act (ACA) requires certain large employers to offer affordable, minimum value health coverage to their full-time employees or pay a penalty. The employer penalties are also known as "shared responsibility" or "pay or play" penalties. A large employer is only liable for a pay or play penalty if one or more of its full-time employees receive a subsidy for coverage under an insurance Exchange.

On Feb. 12, 2014, the IRS published final regulations on the ACA's employer shared responsibility rules. These regulations finalize provisions in proposed regulations released by the IRS on Jan. 2, 2013. Under the final regulations, **applicable large employers that have fewer than 100 full-time employees generally will have an additional year, until 2016, to comply with the pay or play rules.** Applicable large employers with 100 or more full-time employees must comply with the pay or play rules starting in 2015.

On May 3, 2013, the IRS released a proposed rule on the ACA's minimum value and affordability requirements. This proposed rule includes guidance on how health reimbursement arrangements (HRAs) and wellness program incentives are counted in determining the affordability of employer-sponsored coverage.

Also, on July 24, 2014, the IRS released Revenue Procedure 2014-37 (Rev. Proc. 2014-37) to index the ACA's affordability contribution percentage for 2015. For plan years beginning in 2015, employer-sponsored coverage will generally be considered affordable under the pay or play rules if the employee's required contribution for self-only coverage does not exceed **9.56 percent** of the employee's household income for the year. However, applicable large employers using an affordability safe harbor **may have to continue using a contribution percentage of 9.5 percent to measure their plan's affordability in 2015.**

AFFORDABILITY DETERMINATION

The affordability of health coverage offered by an applicable large employer is a key point in determining whether the employer will be subject to a shared responsibility penalty. In general, an applicable large employer that offers health coverage to substantially all of its full-time employees (and dependents) may be subject to a shared responsibility penalty if the health coverage does not provide minimum value or is unaffordable.

Under the ACA, an employer's health coverage is considered affordable if the employee's required contribution to the plan does not exceed **9.5 percent** of the employee's household income for the taxable year

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(adjusted to 9.56 percent for plan years beginning in 2015 under Rev. Proc. 2014-37). "Household income" means the modified adjusted gross income of the employee and any members of the employee's family, including a spouse and dependents.

Because an employer generally will not know an employee's household income, the IRS has provided **three affordability safe harbors** that employers may use to determine affordability based on information that is available to them. Note that these affordability safe harbors specifically refer to **9.5 percent** as the required contribution. Thus, based on a literal reading of the affordability safe harbor rules, applicable large employers using any of the affordability safe harbors in 2015 will measure their plan's affordability using a required contribution of 9.5 percent (instead of the adjusted 9.56 percent). The IRS may issue guidance in the future to address this disconnect.

SAFE HARBOR APPLICATION

The affordability safe harbors are all **optional**. An employer may choose to use one or more of the affordability safe harbors for all its employees or for any reasonable category of employees, provided it does so on a uniform and consistent basis for all employees in a category. Reasonable categories of employees generally include:

- Specified job categories;
- Nature of compensation (for example, salaried or hourly);
- Geographic location; and
- Similar bona fide business criteria.

A listing of employees by name (or other specific criteria having substantially the same effect) is not considered a reasonable category.

The affordability safe harbors are only used to determine whether an employer's coverage satisfies the affordability test for purposes of the employer shared responsibility penalty. The safe harbors do not affect an employee's eligibility for an Exchange subsidy, which is based on the affordability of employer-sponsored coverage relative to an employee's household income.

This means that, in some instances, an employer's offer of coverage to an employee could be considered:

- Affordable (for example, based on W-2 wages) for purposes of determining whether the employer is subject to a penalty; and, at the same time,
- Unaffordable (based on household income) for purposes of determining whether the employee is eligible for an Exchange subsidy.

Changes to the Affordability Percentage for 2015

IRS Rev. Proc. 2014-37 adjusts the ACA's affordability contribution percentage for 2015. For plan years beginning in 2015, employer-sponsored coverage will generally be considered affordable under the pay or play rules if the employee's required contribution for self-only coverage does not exceed **9.56 percent** of the employee's household income for the year. However, applicable large employers using an affordability safe harbor **may have to continue using a contribution percentage of 9.5 percent** to measure their plan's affordability in 2015

The general employer mandate affordability rules determine affordability by reference to the rules for determining premium tax credit eligibility. However, the affordability safe harbors do not reference the premium tax credit eligibility rules. Instead, **the safe harbor rules specifically use 9.5 percent** as the required contribution.

Thus, based on a literal reading of the affordability safe harbor rules, applicable large employers using any of the affordability safe harbors in 2015 will measure their plan's affordability using a required contribution of 9.5 percent (instead of the adjusted 9.56 percent). Applicable large employers who are not using any of the affordability safe harbors in 2015 will apply the required contribution percentage under the premium tax credit eligibility rules. As a result, these employers can measure their health plan's affordability using a required contribution of 9.56 percent.

The IRS may issue guidance in the future to address this disconnect.

AFFORDABILITY SAFE HARBORS

An employer may use one or more of the affordability safe harbors if it offers its full-time employees (and dependents) the opportunity to enroll in minimum essential

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coverage under a health plan that provides minimum value with respect to the self-only coverage offered to the employees.

Form W-2 Safe Harbor

Under the Form W-2 safe harbor, an employer may determine the affordability of its health coverage by reference **only to an employee's wages from that employer**, instead of by reference to the employee's household income. Wages for this purpose is the amount that is required to be reported in Box 1 of the employee's Form W-2.

An employer satisfies the Form W-2 safe harbor with respect to an employee if the employee's required contribution for the calendar year for the employer's lowest cost self-only coverage that provides minimum value during the entire calendar year (excluding COBRA or other continuation coverage except with respect to an active employee eligible for continuation coverage) **does not exceed 9.5 percent of that employee's Form W–2 wages** from the employer for the calendar year.

Eligibility for the Form W-2 Safe Harbor

To be eligible for the Form W-2 safe harbor, the employee's required contribution must remain a consistent amount or percentage of all Form W–2 wages during the calendar year (or during the plan year for plans with non-calendar year plan years). Thus, an applicable large employer is not permitted to make discretionary adjustments to the required employee contribution for a pay period. A periodic contribution that is based on a consistent percentage of all Form W–2 wages may be subject to a dollar limit specified by the employer.

Timing of the Form W-2 Safe Harbor

Employers determine whether the Form W-2 safe harbor applies after the end of the calendar year and on an employee-by-employee basis, taking into account W-2 wages and employee contributions.

Partial-Year Offers of Coverage

For an employee who was not offered coverage for an entire calendar year, the Form W-2 safe harbor is applied by:

- Adjusting the employee's Form W-2 wages to reflect the period when the employee was offered coverage; and
- Comparing the adjusted wage amount to the employee's share of the premium for the employer's lowest cost self-only coverage that provides minimum value for the periods when coverage was offered.

Specifically, the amount of the employee's compensation for purposes of the Form W-2 safe harbor is determined by multiplying the wages for the calendar year by a fraction equal to the number of calendar months for which coverage was offered over the number of calendar months in the employee's period of employment with the employer during the calendar year. For this purpose, if coverage is offered during at least one day during the calendar month, or the employee is employed for at least one day during the calendar month, the entire calendar month is counted in determining the applicable fraction.

Rate of Pay Safe Harbor

The rate of pay safe harbor was designed to allow employers to prospectively satisfy affordability without the need to analyze every employee's wages and hours.

For hourly employees, the rate of pay safe harbor allows an employer to:

- Take the lower of the hourly employee's rate of pay as of the first day of the coverage period (generally, the first day of the plan year) or the employee's lowest hourly rate of pay during the calendar month;
- Multiply that rate by 130 hours per month (the benchmark for full-time status for a month); and
- Determine affordability for the calendar month based on the resulting monthly wage amount.

Specifically, the employee's monthly contribution amount (for the self-only premium of the employer's lowest cost coverage that provides minimum value) is affordable for a calendar month if it is equal to or lower than 9.5 percent of the computed monthly wages (that is, the employee's applicable hourly rate of pay multiplied by 130 hours).

The final regulations, unlike the proposed regulations, permit an employer to use the rate of pay safe harbor even if an hourly employee's rate of pay is reduced during the year.

For salaried employees, monthly salary as of the first day of the coverage period would be used instead of hourly salary multiplied by

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130 hours. However, if the monthly salary is reduced, including due to a reduction in work hours, the rate of pay safe harbor may not be used.

Federal Poverty Line Safe Harbor

An employer may also rely on a design-based safe harbor using the federal poverty line (FPL) for a single individual. The FPL safe harbor allows employers to disregard certain employees in determining the affordability of health coverage (that is, employees who cannot receive an Exchange subsidy because of their income level or eligibility for Medicare, and therefore cannot trigger an employer's liability for a shared responsibility penalty). The FPL safe harbor also provides employers with a predetermined maximum amount of employee contribution that in all cases will result in the coverage being deemed affordable.

Employer-provided coverage is considered affordable under the FPL safe harbor if the employee's required contribution for the calendar month for the lowest cost self-only coverage that provides minimum value does not exceed 9.5 percent of the FPL for a single individual for the applicable calendar year, divided by 12. The final regulations allow employers to use any of the poverty guidelines in effect within six months before the first day of the plan year for purposes of this safe harbor.

HRA CONTRIBUTIONS AND WELLNESS PROGRAM INCENTIVES

The proposed rule from May 3, 2013 includes special rules for determining how HRAs and wellness program incentives are counted in determining the affordability of employer-sponsored coverage. (Employer contributions to health savings accounts (HSAs) do not affect the affordability of employer-sponsored coverage because HSA amounts may generally not be used to pay for health insurance premiums.)

HRA Contributions

Under the proposed rule, amounts made newly available under an HRA that is integrated with an employer-sponsored plan for the current plan year are taken into account only in determining affordability if the employee may either:

- Use the amounts only for premiums; or
- Choose to use the amounts for either premiums or cost-sharing.

Treating amounts that may be used either for premiums or cost-sharing only toward affordability prevents double counting the HRA amounts when assessing minimum value and affordability of employer-sponsored coverage.

Wellness Program Incentives

The proposed rule also contains clarification on affordability when premiums may be affected by wellness programs. Under the proposal, the affordability of an employer-sponsored plan is determined by assuming that each employee fails to satisfy the wellness program's requirements, unless the wellness program is related to tobacco use. This means the affordability of a plan that charges a higher initial premium for tobacco users will be determined based on the premium charged to non-tobacco users, or tobacco users who complete the related wellness program, such as attending smoking cessation classes.

Transition relief is provided in the proposed rule for plan years beginning before Jan. 1, 2015. Under this relief, if an employee receives a premium tax credit because an employer-sponsored health plan is unaffordable or does not provide minimum value, but the employer coverage would have been affordable or provided minimum value had the employee satisfied the requirements of a nondiscriminatory wellness program that was in effect on May 3, 2013, the employer will not be subject to the employer mandate penalty.

The transition relief applies for rewards expressed as either a dollar amount or a fraction of the total required employee premium contribution. Also, any required employee contribution to premium determined based upon assumed satisfaction of the requirements of a wellness program under this transition relief may be applied to the use of an affordability safe harbor.

It is unclear how the delay of the employer mandate penalties will impact this transition relief.

More Information

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