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EMPLOYEE BENEFITS

Affordability Determinations

The Employer Shared Responsibility provisions of the Affordable Care Act require applicable large employers (ALEs) to offer their full-time employees[1] affordable minimum value coverage[2] to avoid potential employer-shared responsibility payments/penalties (ESRPs). ALEs are employers with an average workforce of at least 50 full-time (or equivalent) employees in the preceding calendar year. These provisions provide that employer-offered coverage is considered "affordable" if the required employee contribution amount for the least expensive employee-only level of coverage providing minimum value does not exceed an indexed percentage (adjusted annually) of an individual employee's household income for a given year.

To help employers determine whether the coverage they offer will be affordable to employees without knowing their household income, the IRS issued regulations[3] providing employers with three affordability "safe harbors" that ALEs can use to determine if their plan would be considered affordable for their full-time employees. These three safe harbors are the federal poverty line (FPL) safe harbor, the Form W-2 safe harbor and the rate of pay safe harbor.

An ALE is not required to use a safe harbor to determine affordability, nor are they required to use only one safe harbor for their entire employee population.[4] If an employer chooses to utilize an affordability safe harbor method, an employer may apply different affordability safe harbors to any "reasonable category of employees, provided it does so on a uniform and consistent basis for all employees in a category."[5] Reasonable categories of employees can include "specified job categories, nature of compensation (hourly or salary), geographic location, and similar bona fide business criteria."[6]

[1] Treas. Reg. § 54.4980H-1(a)(21).
[2] In general, a group medical plan provides minimum value coverage if (1) the plan's share of the total allowed cost of benefits provided to an employee is at least 60% and (2) the plan provides substantial coverage of inpatient hospital services and physician services. Treas. Reg. § 1.36B-6(a).
[3] Treas. Reg. § 54.4980H-5(e)(2).
[4] Treas. Reg. § 54.4980H-5(e)(2)(i).
[5] Id.
[6] Id.

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Federal Poverty Line Safe Harbor

The federal poverty line safe harbor allows an employer to use the single individual poverty limit set annually by the Department of Health and Human Services[7] to determine whether the health plan would be considered affordable under the ESRP rules.

Under the federal poverty line safe harbor, an employer's offer of coverage is considered affordable when the ***monthly*** required employee contribution for the least expensive employee-only coverage providing minimum value does not exceed an indexed percentage (adjusted annually) of the applicable FPL for a single individual. This number is divided by twelve, converting the annual federal poverty line amount to a monthly amount. The U.S. mainland, Alaska and Hawaii are subject to separate FPL amounts.

If the employee's monthly contribution is less than or equal to this amount, the employer is considered to have offered affordable coverage to the employee under the FPL safe harbor.

Annual FPL guidelines are typically released in January of a given year, after calendar year plan years have already begun. The regulations allow employers to set affordability based on the FPL guidelines in effect within six months before the first day of the plan year.[8]

The FPL safe harbor is generally considered the simplest safe harbor method to administer. As affordability is based on a poverty-related figure, it also generally requires the greatest employer contribution.

Rate of Pay Safe Harbor

The rate of pay safe harbor allows an employer to use an employee's base rate of pay (hourly or salary) to determine an affordable employee contribution rate for ESRP purposes.

Under the rate of pay safe harbor, an employer's offer of coverage is considered affordable when the ***monthly*** required employee contribution for the least expensive employee-only coverage providing minimum value does not exceed an indexed percentage (adjusted annually) of an employee's monthly wages. For the purposes of this safe harbor, monthly wages for an hourly employee are calculated by using the employee's hourly rate of pay multiplied by 130 hours.[9] 130 hours is the regulatory-based number of hours for this safe harbor and must be used even if the employee works more (or less) hours per month.[10] For salaried employees, their monthly wages would be their monthly salary or annual salary divided by twelve to convert to a monthly amount.

For an employer determining the applicable rate of pay for an hourly employee under this safe harbor, an employer must use the lower of 1) the hourly rate of pay on the first day of the coverage period (i.e., the first day of the plan year); or 2) the employee's lowest hourly rate of pay during the applicable calendar month.[11]

Under the rate of pay safe harbor, an employer determining the rate of pay for a non-hourly employee (e.g., salaried employee) would use an employee's monthly salary as of the first day of the coverage period (i.e., the first day of the plan year). If an employee's monthly salary is reduced during the plan year (e.g., due to a reduction in work hours), the regulations provide that the rate of pay safe harbor may not be used.[12]

Tips and commissions cannot be factored into an employee's rate of pay under this safe harbor.[13] Accordingly, an employer who would like to take commissions or tips into account in determining affordability would have to use the Form W-2 affordability safe harbor.

Typically, an employer utilizes this safe harbor by basing the employee contribution rate for its entire population (or reasonable subcategory of employees) on the lowest paid employee's rate of pay.

[7] https://aspe.hhs.gov/topics/poverty-economic-mobility/poverty-guidelines.
[8] 79 Fed. Reg. 8543, 8565 (Feb. 12, 2014).
[9] Treas. Reg. § 54.4980H-5(e)(2)(iii).
[10] Id.
[11] Id.
[12] 79 Fed. Reg. 8543, 8564 (Feb. 12, 2014).
[13] 79 Fed. Reg. 8543, 8564–8565 (Feb. 12, 2014).

Form W-2 Safe Harbor

Under the Form W-2 safe harbor, an employer uses an employee's wages, as reported in Box 1 of their Form W-2, to determine an affordable employee contribution rate.

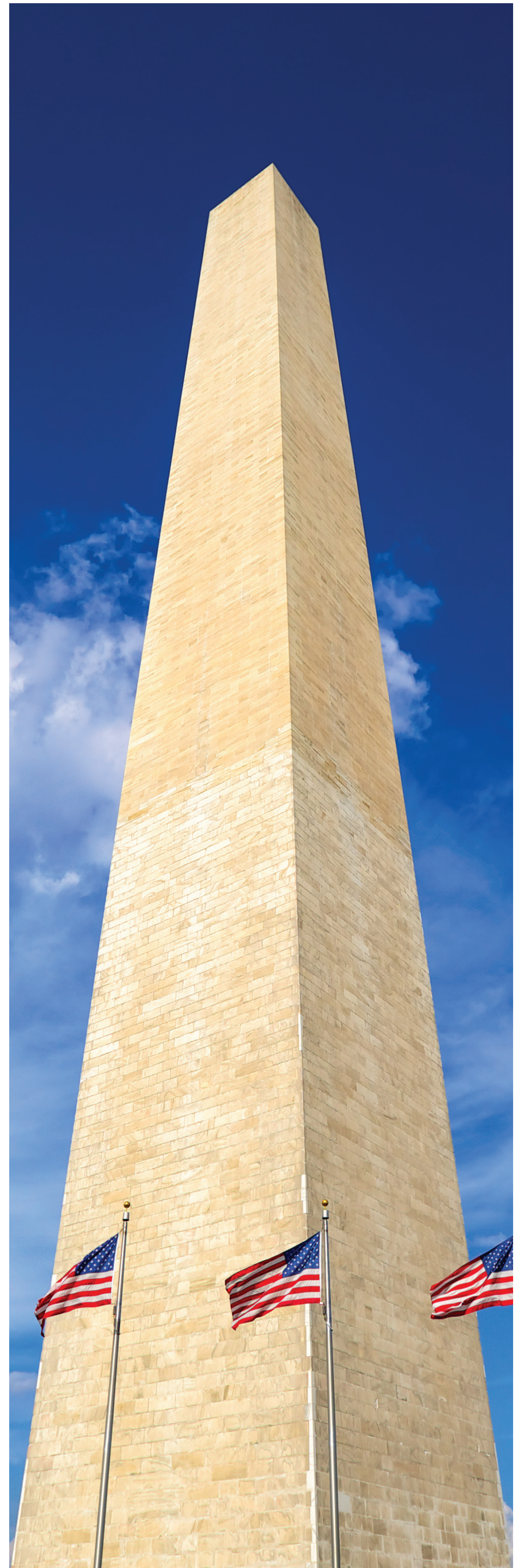
Specifically, this safe harbor provides that an employer's offer of coverage is considered affordable when the employee's required contribution amount for the calendar year for the least expensive employee-only coverage providing minimum value does not exceed an indexed percentage (adjusted annually) of the employee's Form W-2 Box 1 earnings for a given calendar year. Box 1 wages include taxable wages (including bonuses, tips and other employer-provided compensation) but do not include nontaxable employee contributions towards certain health and welfare benefits (i.e., salary reduction contributions for pre-tax benefits under the employer's cafeteria plan and employee retirement contributions).[14]

The Form W-2 safe harbor uses an employee's current annual wages, which cannot be determined until the end of the applicable year, to calculate whether the plan is affordable to the employee in the current year. Inherently, this safe harbor is typically used by employers who can predict with high certainty the Box 1 W-2 wages for each employee at the end of the year.

Under this safe harbor, the employee-required contribution must remain a consistent amount, or a consistent percentage, of all Form W–2 wages during the calendar year (for calendar year plans) or during the plan year (for plans with non-calendar year plan years). This means that an employer utilizing the W-2 affordability safe harbor cannot adjust employee contributions during the applicable year to reflect changes in earning projections for the remaining year.

The regulations provide a special rule allowing employers to use the Form W-2 safe harbor to determine whether the plan is affordable to employees not offered coverage for an entire calendar year.[15] In this circumstance, the safe harbor is applied by multiplying an employee's W-2 wages for the calendar year by a fraction equal to the months for which coverage was offered over the span of their employment for that calendar year. The regulations provide that "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."

[14] *Internal Revenue Service, General Instructions for Forms W-2 and W-3.*
[15] *Treas. Reg. § 54.4980H-5(e)(2)(ii)(B).*



Additional Factors for Affordable Coverage

Additional factors may affect whether the plan is considered affordable to an employee under any of the above safe harbor methods. Three of these additional factors are discussed below:

Impact of Flex Credits

Regardless of which safe harbor method is used by the employer, the calculation of the employee's contribution for affordability purposes will be reduced by certain employer-made contributions, called employer health flex contributions,[16] pursuant to IRS Notice 2015-87. Employer flex contributions will reduce an employee's required contribution towards medical coverage (i.e., they are considered employer contributions towards the cost of medical coverage) for purposes of calculating whether the coverage is affordable to employees if these conditions are satisfied:

- The contributions are made under a Section 125 cafeteria plan
- The contributions may be used to pay for minimum essential coverage (i.e., medical coverage)
- The contributions are not available to the employee as a taxable benefit (e.g., the employee does not have the option to elect to receive the employer flex credit as taxable wages if they waive medical coverage); and
- The contributions cannot be used for anything not defined as medical care under Internal Revenue Code §213

As a result, if the flex credits an employer makes available under its Section 125 plan can be used for non-medical benefits, such as HSA contributions, DCAP benefits, etc., the credits will not be regarded as an employer contribution and will not reduce the employee's required contribution to determine the affordability of the employer's medical coverage.

Impact of Wellness Incentives

Wellness incentives may also impact the affordability of employer coverage. Under IRS regulations, any tobacco-related wellness incentive that affects premiums will be treated as earned. Any incentive unrelated to tobacco (or including a component unrelated to tobacco) will not be treated as earned when determining whether the coverage is considered affordable to employees.[17] This means that the affordability of a plan that charges a higher employee cost for tobacco use will be determined based on the rate charged to those who do not use tobacco (or who have fulfilled the requirement to complete a tobacco-related wellness program to qualify for the premium incentive). In contrast, a plan that requires a higher employee contribution if the employee does not meet the requirements to qualify for a wellness incentive **unrelated** to tobacco use will determine affordability based on the rate charged to those who do **not** earn the wellness incentive.

Impact of Opt-Out/Cash-In-Lieu Arrangements

Opt-out payments, also called cash-in-lieu or cash-out benefits, are payments made by employers to employees when an employee declines coverage under the employer-sponsored plan. These payments can also affect plan affordability. Currently, whether the opt-out arrangement affects plan affordability depends on two factors: when the opt-out arrangement was implemented and whether the opt-out arrangement imposes certain conditions on employees who participate in the opt-out arrangement.[18]

[16] Note that HSA contributions made by the employer will not affect the affordability determinations as HSA funds generally may not be used to pay for health insurance premiums.
[17] Treas. Reg. §1.36B-2(c)(3)(v)(A)(4).
[18] Notice 2015-87.

Grandfathered Opt-Out Arrangements

Because the proposed regulations regarding eligible opt-out arrangements are not yet finalized, certain opt-out arrangements may be temporarily grandfathered. A grandfathered opt-out arrangement will not adversely affect the affordability of the employer's medical coverage, even if the arrangement does not qualify as an eligible opt-out arrangement (as discussed below). According to IRS Notice 2015-87, an opt-out arrangement will be grandfathered (until the effective date of the final regulations) if it was adopted on or before December 16, 2015.

"For this purpose, an opt-out arrangement will be treated as adopted after December 16, 2015, unless (1) the employer offered the opt-out arrangement (or a substantially similar opt-out arrangement) with respect to health coverage provided for a plan year including December 16, 2015; (2) a board, committee, or similar body or an authorized officer of the employer specifically adopted the opt-out arrangement before December 16, 2015; or (3) the employer had provided written communications to employees on or before December 16, 2015 indicating that the opt-out arrangement would be offered to employees at some time in the future."

Eligible Opt-Out Arrangements

Under proposed IRS regulations issued in 2016,[19] an opt-out payment arrangement does not adversely impact the affordability of an employer's medical coverage if the receipt of the opt-out payment is (1) available only to employees who waive the employer-sponsored medical coverage and (2) conditioned on the employee providing reasonable evidence that the employee and their "expected tax family" has or will have minimum essential coverage[20] (other than coverage in the individual market) during the period of coverage to which the opt-out arrangement applies.

Other Opt-Out Arrangements

Suppose the opt-out arrangement qualifies as neither a grandfathered opt-out arrangement nor an eligible opt-out arrangement. In that case, the opt-out payment amount available to employees must be included in the employee's share of the cost of coverage when determining affordability according to IRS guidance.

Example: The employee cost for single coverage under Employer A's lowest cost medical coverage option providing minimum value is $250 per month. Employer A also sponsors an opt-out arrangement (which is not grandfathered) under which employees who waive medical coverage receive $400 per month with no conditions (i.e., employees are not required to provide reasonable evidence that they and their expected tax families have or will have minimum essential coverage other than coverage in the individual market). The employee cost for affordability purposes is $650 per month.

To avoid employer-shared responsibility payments, ALEs should consider the specific nature of compensation for their full-time employees and the structure of their contribution strategy for the group health plan when choosing an affordability safe harbor. ALEs should consult with their employee benefits attorney or tax advisor if they have specific questions.

[19] *The IRS has indicated that employers may rely on the proposed regulations until final regulations are published.*
[20] *Minimum essential coverage is coverage under any group health plan other than an excepted benefit.*

How Brown & Brown Can Help

Connect with your Brown & Brown service team to learn more about how we can help find solutions to fit your unique needs.

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