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Affordability Safe Harbors

The Patient Protection and Affordable Care Act (ACA) imposes penalties under Section 4980H(a) of the Internal Revenue Code on Applicable Large Employers (ALEs) who fail to offer minimum essential coverage to "substantially all" (at least 95%) of their full-time employees and dependent children until the age of 26.[1] In addition, an ALE that fails to offer affordable, minimum value coverage to any full-time employee faces penalty exposure under Section 4980H(b) of the Internal Revenue Code if a full-time employee receives a premium tax credit from the Marketplace. Coverage is affordable for an employee if the employee's contribution toward the lowest-cost, self-only, minimum value coverage does not exceed a specified percentage of the employee's household income (9.61% for plan beginning in 2022 and 9.12% for plan years beginning in 2023). The annual penalty under Section 4980H(b) is $3,000 for each full-time employee who triggers the penalty, and this amount is indexed annually ($4,120 in 2022 and $4,320 in 2023). ALEs will report the affordability of their offers of coverage to the IRS on Forms 1095-C, which will be used by the IRS to assess any penalties. The IRS regulations permit ALEs to use one or more affordability safe harbors. However, an ALE can use a safe harbor only if —

The employer offers its full-time employees and their dependent children the opportunity to enroll in minimum essential coverage (MEC) under an eligible employer-sponsored plan, and

The coverage provides minimum value (MV) with respect to the self-only coverage offered to the employee.

An ALE may choose to apply a safe harbor to any reasonable category of employees, provided it does so on a uniform and consistent basis for all employees in that category. The regulations provide that reasonable categories for this purpose generally include specified job categories, nature of compensation (hourly or salaried), geographic location, and similar bona fide business criteria. The charts below explain the three available safe harbors and the calculation methods for each. Remember: **When measuring the affordability of an offer of coverage, the employer looks solely at the contribution that would be paid by the employee for the lowest cost, self-only coverage option that provides minimum value, regardless of whether the employee actually elected that level of coverage**.

[1] A son or daughter of the full-time employee; or a legally adopted individual of the full-time employee or an individual who is lawfully placed with the full-time employee for legal adoption. Spouses, foster children, and stepchildren are not considered dependents for purposes of the mandate.

Special Rules When Using Safe Harbors to Determine Affordability

Wellness Programs. Employers that offer wellness rewards or surcharges (together, referred to as "incentives" in this resource) are subject to special affordability rules.

Generally, employers that offer wellness incentives must assume that every employee failed to qualify for the incentive when measuring affordability, regardless of whether the employee actually received the incentive. Similarly, if an employer provides incentives to participants for COVID-19 vaccinations, then the employer should determine whether the program is a wellness program. If a vaccine incentive program is a wellness program, then the employer should treat the incentive like any other wellness program incentive tied to its medical benefits and assume that employees will not qualify for the wellness program incentive for purposes of determining affordability.

The only exception to this rule applies to tobacco-related incentives. Employers that offer a tobacco-related incentives must assume that every employee qualified for incentive when measuring affordability, regardless of whether the employee actually received the tobacco-related incentive.

Cafeteria Plan Flex Credits/Defined Contributions, Opt-Out Incentives, and Health Reimbursement Arrangements that Reimburse Premium Contributions. Employers with plans that include these special features will need to adjust the cost of coverage to an employee when calculating affordability. (Although note that proposed regulations permit opt-out incentives that are structured as a conditional opt-out payment to be excluded when determining affordability.) For information on these plan designs and how to they impact affordability, please see our Spotlight articles IRS Proposed Rules on Opt-Out Bonuses and Affordability and Flex Credits and Affordability of Coverage.

W-2 Safe Harbor

Affordability Rate	*2020: 9.78%*	*2021: 9.83%*	*2022: 9.61%*	*2023: 9.12%*

How It Works:

- **For full year coverage. *Employee share of the lowest cost, self-only, MV coverage ≤ Affordability rate x W-2 Box 1 wages (or, if applicable, adjusted Box 1 wages)***
- **For partial year coverage, use adjusted Box 1 wages. *Box 1 wages x months covered / months employed = Adjusted Box 1 wages***
- 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 non-calendar year plans). Employers are not permitted to make discretionary adjustments to the required employee contribution for a pay period.
- Application of this safe harbor is determined after the end of the calendar year and on an employee-by-employee basis.
- Compare the employee contribution for lowest-cost, self-only, MV coverage against the employee's current year W-2 wages as reported in Box 1 of Form W-2.
- If the cost does not exceed the applicable affordability rate times the employee's box 1 wages, the coverage is affordable.

Examples:

Full-Time Employee for Full Calendar Year. Sally is employed from January 1, 2022 through December 31, 2022. She declined coverage for the year. In 2022, the annual employee contribution for the lowest cost, self-only, MV coverage is $1,200 and Sally's W-2 Box 1 wages are $24,000. Because the employee contribution is less than 9.61% of Sally's Box 1 wages ($1,200 is 5% of $24,000), the coverage offered is affordable.

Employee Not Employed Full-Time for Full Calendar Year. Billy is employed from January 1, 2022 through December 31, 2022. Billy moves to full-time on April 1 and he and his dependent children enroll in his employer's MV plan for nine months (April 1 – December 31). For 2022, to determine affordability, the employer compares the employee contribution for the lowest cost, self-only, MV coverage against Billy's adjusted W-2 Box 1 wages. The monthly contribution for the lowest cost, self-only, MV coverage is $100 per month and Billy's W-2 Box 1 wages are $24,000. Billy's wages are multiplied by 9/12 (9 months of coverage over 12 month's employment). Therefore, his adjusted W-2 Box 1 wages are $18,000. Because the employee contribution for self-only coverage in 2022 is less than 9.61% of Billy's adjusted W-2 Box 1 wages for 2022 ($900 is 5% of $18,000), the coverage offered is affordable.

Partial-Year Employee. Walter is employed from May 15, 2022 through December 31, 2022. After a 2 ½ month waiting period, Walter and his dependent children are offered his employer's MV plan from August 1, 2022 through December 31, 2022. For 2022, Walter elects self-only coverage and contributes $500 for the five-month period during which he was offered coverage and his W-2 Box 1 wages are $15,000. His W-2 Box 1 wages are multiplied by 5/8 (five calendar months of coverage over eight months of employment during the calendar year). His adjusted wages are $9,375. Because $500 is less than 9.61% of $9,375 ($500 is 5.33% of $9,375), the coverage offered is affordable.

Practical Pointers:

- W-2 Box 1 wages includes taxable wages, bonuses, tips, and other compensation paid by the employer, as defined in Code Section 3401(a). Box 1 is not the employee's annual gross salary, as Box 1 takes into account the reduction of the gross salary through pretax contributions, such as pre-tax contributions to a 401(k) plan or pre-tax cafeteria plan salary reductions.
- Year-end W-2 Box 1 wages can be used to prospectively estimate affordable coverage for following calendar (or non-calendar) year. But note that this will only be an estimate, because wages and applicable reductions of gross salary may differ from year to year. Employers may be liable for penalties if coverage is unaffordable due to an incorrect estimate.
- Using the lowest paid employee's wages does not automatically make coverage affordable for all employees. Analysis is still required.

Rate of Pay Safe Harbor

Affordability Rate	2020: 9.78%	2021: 9.83%	2022: 9.61%	2023: 9.12%

How It Works:

- **For hourly employees.** ***Monthly employee share of the lowest cost, self-only, MV coverage ≤ hourly wage rate x 130 x affordability rate***
- **For non-hourly employees.** ***Monthly employee share of the lowest cost, self-only, MV coverage ≤ monthly salary (as of 1st day of coverage period) x affordability rate***
- This safe harbor cannot be used for non-hourly employees (e.g., salaried employees) if monthly compensation is reduced, including due to a reduction in work hours.
- This safe harbor cannot be used for tipped employees or for employees who are compensated solely on the basis of commissions.
- **Hourly employees**. On a monthly basis: (1) take the lower of the employee's hourly 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; (2) multiply that rate by 130 hours per month; and (3) determine affordability based on the resulting monthly wage amount. Coverage is affordable if the employee contribution amount for the lowest cost, self-only coverage is equal to or lower than the result of steps 1-3. If employee's hourly rate decreases mid-year, the lower pay rate must be used to calculate affordability for the months the lower rate is paid to employee.
- **Non-hourly employees** (e.g., salaried employees). On a monthly basis, compare the employee contribution for the lowest cost, self-only, MV coverage to the employee's monthly salary as of the first day of the coverage period.

Examples:

Hourly Employee. Larry and his dependent children are offered MV coverage by his employer. Larry is paid $7.25 per hour in 2022. His monthly wage, for purposes of affordability, is $942.50 (130 x $7.25) and the monthly contribution for the lowest cost, self-only, MV coverage is $47. Because $47 is less than 9.83% times his monthly wage ($47 < 130 x $7.25 x 9.61%), the coverage offered is affordable.

Hourly Employee With Increase in Pay During the Year. Greta and her dependent children are offered MV coverage by her employer. She is employed from May 1, 2022 through December 31, 2022. The employee contribution for the lowest cost, self-only, MV coverage is $100 per calendar month. From May 1, 2022 through October 31, 2022, Greta is paid $10 per hour. From November 1, 2022 through December 31, 2022, Greta is paid $12 per hour. For May through October 2022, affordability is determined by comparing the assumed income of $1,300 (130 X $10) per month to the employee contribution of $100 per calendar month. For November through December 2022, the employer may assume that Greta earned $1,300 per calendar month because Greta's $10 per hour is the lower of the employee's hourly rate of pay at the <u>beginning of the coverage period</u> and the lowest hourly rate of pay for the calendar month. Accordingly, affordability is determined by comparing the assumed income of $1,300 per month to the employee contribution of $100 per calendar month. Because $100 is less than 9.61% times $1300, the coverage is affordable from May to December.

Hourly Employee With Decrease in Pay During the Year. Same facts as above, except Greta has a <u>reduction</u> in pay to $7.50 per hour for months November and December 2022. Greta's assumed income for November and December is $975 because her lowest rate of pay in November and December is $7.50. Accordingly, affordability is determined by comparing the assumed income of $975 per month to the employee contribution of $100. Because $100 is more than 9.61% times $975, coverage is unaffordable and Greta's employer may be subject to 4980H(b) penalties for months November and December if Greta goes to the Marketplace and qualifies for a premium tax credit.

Practical Pointers:

- This safe harbor can be used at the beginning of plan year to set maximum affordability amount (but employers will still have to monitor any reduction in pay).
- Can be a "fail-safe" if affordability is based on lowest paid employee (but employers will still have to monitor any reduction in pay).
- Any increases or decreases in the hours worked by employee are not taken into account. When measuring this affordability safe harbor, 130 hours per month is used regardless of how many hours the employee actually works.

Federal Poverty Line Safe Harbor

Affordability Rate	*2020: 9.78%*	*2021: 9.83%*	*2022: 9.61%*	*2023: 9.12%*

How It Works:

Employee share of the lowest cost, self-only, MV coverage ≤ FPL guideline/12 x affordability rate

- This safe harbor uses the Federal Poverty Line for the single individual in the state in which the individual is employed, issued for the applicable calendar year (or most recently published guidelines for non-calendar year plans).
- To use this safe harbor, the employer may use the federal poverty level that is in effect within six months before the beginning of the plan year.
- Coverage will be affordable if the employee's contribution for the lowest cost, self-only MV coverage does not exceed the monthly affordability amount of the federal poverty line for a single individual, divided by 12.

100% of FPL Guidelines:

2021: $12,880 (for the 48 contiguous states and D.C.)

- Alaska: $16,090
- Hawaii: $14,820

2022: $13,590 (for the 48 contiguous states and D.C.)

- **Alaska:** $16,990
- **Hawaii:** $15,630

2023: TBD

Examples:

Calendar Year Plan (Example A). Employer's plan year begins January 1, 2022 and ends December 31, 2022. The employer uses 2021 FPL guidelines to set rates in time for open enrollment. The maximum affordable employee contribution for the lowest cost self-only coverage providing MV is $103.15 ($12,880/12 x 9.61%)

Off-Calendar Year Plan (Example B). Employer's plan year begins October 1, 2022 and ends September 30, 2023. For this plan year the employer must use the 2022 FPL threshold. The maximum affordable employee contribution for the lowest cost, self-only coverage providing MV is $108.83 ($13,590/12 x 9.61%).

Off-Calendar Year Plan (Example C). Employer's plan year begins May 1, 2022 and ends April 30, 2023. The employer uses the 2021 FPL guidelines in order to set affordability rates. The maximum affordable employee contribution for the lowest cost self-only coverage providing MV is $103.15 ($12,880/12 x 9.61%).

Off-Calendar Year Plan (Example D). Same facts as example C except employer uses 2022 FPL guidelines to set affordability rates. The maximum affordable employee contribution for the lowest cost self-only coverage providing MV is $108.83 ($13,590/12 x 9.61%).

Calendar Year Plan (Example E- future plan year). Employer's plan begins January 1, 2023 and ends December 31, 2023. The employer uses 2022 FPL guidelines to set affordability rates. The maximum affordable employee contribution for the lowest cost self-only coverage providing MV is $103.28 ($13,590/12 x 9.12%).

Practical Pointers:

- This safe harbor may be most beneficial to employers with large variable hour, seasonal, tipped or commissioned employee populations.
- Meeting this safe harbor allows for a special "offer" exception under 4980H (a) which may be beneficial to employers with mandatory enrollment.

The intent of this analysis is to provide general information regarding the provisions of current federal laws and regulation. It does not necessarily fully address all your organization's specific issues. It should not be construed as, nor is it intended to provide, legal advice. Your organization's general counsel or an attorney who specializes in this practice area should address questions regarding specific issues.