

# ACA COMPLIANCE OVERVIEW



## Pay or Play Penalty—Affordability Safe Harbors

The Affordable Care Act (ACA) requires applicable large employers (ALEs) to offer affordable, minimum value health coverage to their full-time employees or pay a penalty. This employer mandate provision is also known as the “employer shared responsibility” or “pay or play” rules. An ALE 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 Exchange.

The pay or play final regulations provide guidance on determining affordability of an employer-sponsored plan, including **three optional safe harbors** that employers may use. This ACA Overview describes the ACA’s affordability determination and safe harbors for purposes of these rules.

### LINKS AND RESOURCES

- IRS [final regulations](#) and [Q&As](#) on the employer shared responsibility rules
- [Rev. Proc. 2014-37](#) indexed the affordability percentage for 2015; [Rev. Proc. 2014-62](#) indexed the affordability percentage for 2016; [Rev. Proc. 2016-24](#) indexed the affordability percentage for 2017; [Rev. Proc. 2017-36](#) indexed the affordability percentage for 2018; [Rev. Proc. 2018-34](#) indexed the affordability percentage for 2019; [Rev. Proc. 2019-29](#) indexed the affordability percentage for 2020; [Rev. Proc. 2020-36](#) indexed the affordability percentage for 2021; [Rev. Proc. 2021-36](#) indexed the affordability percentage for 2022; [Rev. Proc. 2022-34](#) indexed the affordability percentage for 2023.
- On Dec. 16, 2015, the IRS confirmed in [Notice 2015-87](#) that ALEs using an affordability safe harbor may rely on the adjusted affordability contribution percentages.

## Applicable Large Employer

Only ALEs are subject to the employer shared responsibility rules.

- ALEs are employers that employ, on average, at least 50 full-time employees, including full-time equivalents (FTEs), during the preceding calendar year.
- All ALEs are subject to these rules, including for-profit, nonprofit and government employers.

## Affordability Safe Harbors

The IRS has provided three optional safe harbors that ALEs may use to determine their plan’s affordability:

- Form W-2 safe harbor;
- Rate of pay safe harbor; and
- Federal poverty level safe harbor.

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## Affordability Determination

Under the employer shared responsibility rules, an ALE that offers health coverage to substantially all of its full-time employees (and dependents) may be subject to a penalty if the health coverage does not provide minimum value or is unaffordable. For this purpose, an ALE's health coverage is considered affordable if the employee's required contribution to the plan does not exceed **9.5%** (as adjusted) of the employee's household income for the taxable year. "Household income" is the modified adjusted gross income of the employee and any family members (including a spouse and dependents).

The affordability test applies only to the portion of **the annual premiums for self-only coverage**, and does not include any additional cost for family coverage. Also, if an employer offers multiple health coverage options, the affordability test applies to the lowest-cost option that provides minimum value.

## Changes to the Affordability Percentage

The affordability contribution percentage is adjusted annually for inflation. IRS [Notice 2015-87](#) clarified that ALEs using an affordability safe harbor may use the adjusted affordability contribution percentages. Employer-sponsored coverage will generally be considered affordable under the employer shared responsibility rules if the employee's required contribution for self-only coverage does not exceed:

- **9.56%** of the employee's household income for the year, for 2015 plan years;
- **9.66%** of the employee's household income for the year, for 2016 plan years;
- **9.69%** of the employee's household income for the year, for 2017 plan years;
- **9.56%** of the employee's household income for the year, for 2018 plan years;
- **9.86%** of the employee's household income for the year, for 2019 plan years;
- **9.78%** of the employee's household income for the year, for 2020 plan years;
- **9.83%** of the employee's household income for the year, for 2021 plan years;
- **9.61%** of the employee's household income for the year, for 2022 plan years; and
- **9.12%** of the employee's household income for the year, for 2023 plan years.

## Overview of the Affordability Safe Harbors

Because an employer generally will not know an employee's household income, the IRS has provided three optional affordability safe harbors that ALEs may use to determine affordability based on information that is available to them—the **Form W-2 safe harbor**, the **rate of pay safe harbor** and the **federal poverty level safe harbor**.

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

## Safe Harbor Application

The three 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.

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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 ALE's coverage satisfies the affordability test under the employer shared responsibility penalty. These 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 ALE'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.

## Form W-2 Safe Harbor

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

An ALE satisfies the Form W-2 safe harbor for an employee if the employee's required contribution for the calendar year for the ALE'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% (as adjusted) 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 ALE may not 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

ALEs 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

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- 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 ALE 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 ALEs 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 ALE 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% (as adjusted) 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, allow an ALE 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 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 ALE may also rely on a design-based safe harbor using the federal poverty line (FPL) for a single individual. 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% (as adjusted) of the FPL for a single individual for the applicable calendar year, divided by 12.

ALEs may 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.

The federal poverty guidelines differ based on household size, and different levels apply for Alaska and Hawaii. The FPL for a single individual in the 48 contiguous states and D.C. is **\$11,770** for 2015, **\$11,880** for 2016, **\$12,060** for 2017, **\$12,140** for 2018, **\$12,490** for 2019, **\$12,760** for 2020, **\$12,880** for 2021 and **\$13,590** for 2022. See HHS’ [website](#) for more information.

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The FPL safe harbor allows ALEs 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 ALE's liability for an employer shared responsibility penalty). The FPL safe harbor also provides ALEs with a predetermined maximum amount of employee contribution that in all cases will result in the coverage being deemed affordable.

## Cafeteria Plan Contributions, HRA Contributions & Wellness Program Incentives

[Notice 2015-87](#) also addressed how employer contributions to a cafeteria plan (flex contributions), health reimbursement arrangements (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.

On May 3, 2013, the IRS released a [proposed rule](#) on the premium tax credit that included guidance on how flex contributions, HRAs and wellness program incentives are counted in determining affordability of employer-sponsored coverage. A separate [final rule](#) on the individual mandate was issued on Nov. 26, 2014, addressing similar issues. **Notice 2015-87 generally clarified that the same treatment in the premium tax credit proposed rule and individual mandate final rule applies for purposes of determining affordability under the employer shared responsibility rules.**

### Flex Contributions

For purposes of determining the affordability of coverage, the November 2014 individual mandate final regulations provide that the required contribution is **reduced** by any contributions made by an employer (also called employer **health flex contributions**) under a Section 125 cafeteria plan that may not be taken as a taxable benefit, may be used to pay for minimum essential coverage and may be used only to pay for medical care.

Notice 2015-87 clarifies that this rule also applies for purposes of the employer shared responsibility rules. Thus, health flex contributions made available for the current plan year **are taken into account** for purposes of determining an individual's required contribution. However, if an employee may use employer contributions to a cafeteria plan for non-health care benefits (such as dependent care or group term life insurance) or may receive them as cash, those amounts **do not reduce the employee's required contribution.**

**Example 1 (Health Flex Contribution Reduces Dollar Amount of Employee's Required Contribution).** Employer offers employees coverage under a group health plan through a Section 125 cafeteria plan. An employee electing self-only coverage under the health plan is required to contribute \$200 per month toward the cost of coverage. Employer offers employer flex contributions of \$600 for the plan year that may only be applied toward the employee share of contributions for the group health coverage or contributed to a health flexible spending arrangement (health FSA).

**Conclusion.** The \$600 employer flex contribution is a **health flex contribution** and **reduces the employee's required contribution** for the coverage for purposes of the employer shared responsibility rules (including the affordability safe harbors). Because the \$600 employer flex contribution is a health flex contribution, the \$600 is taken into account as an employer contribution (and therefore reduces the employee's required contribution), regardless of whether the employee elects to apply the health flex contribution toward the employee contribution for the group health coverage or elects to contribute it to the health FSA. For purposes of the employer shared responsibility rules and the related reporting under Section 6056, the employee's required contribution for the group health coverage is \$150 (\$200 - \$50) per month.

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## **Example 2 (Employer Flex Contribution Does Not Reduce Dollar Amount of Employee's Required Contribution).**

Employer offers employees coverage under a group health plan through a Section 125 cafeteria plan. An employee electing self-only coverage under the health plan contributes \$200 per month toward the cost of coverage. Employer offers employer flex contributions of \$600 for the plan year that can be used for any benefit under the Section 125 cafeteria plan (including benefits not related to health) but are not available as cash.

**Conclusion.** Because the \$600 employer flex contribution is **not usable exclusively for medical care**, it is not a health flex contribution and therefore **does not reduce the employee's required contribution** for the coverage under the employer shared responsibility rules. For purposes of the employer shared responsibility rules and the related reporting under Section 6056, the employee's required contribution is \$200 per month.

## **Example 3 (Employer Flex Contribution Does Not Reduce Dollar Amount of Employee's Required Contribution).**

Same as in Example 2, except that the employee may also elect to receive the \$600 employer flex contribution as cash or other taxable compensation.

**Conclusion.** Same as in Example 2, because the employer flex contribution is not a health flex contribution. The same conclusion would apply if the employer flex contribution were available to pay for health benefits or to be taken as cash or other taxable compensation, but not available to pay for other types of benefits.

However, Notice 2015-87 provided **transition relief for plan years beginning before Jan. 1, 2017**. For purposes of both the employer shared responsibility rules and the related Section 6056 reporting requirements, any flex contribution that may be used towards both health and non-health benefits will be treated as **reducing an employee's required contribution**.

The relief is not available for flex contribution arrangements offering non-health benefits that either were adopted after Dec. 16, 2015, or substantially increase the amount of the flex contribution after Dec. 16, 2015.

## **HRA Contributions**

Under special rules in the November 2014 individual mandate final regulations, 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**. This special rule is intended to prevent double counting the HRA amounts when assessing minimum value and affordability of employer-sponsored coverage. Notice 2015-87 clarifies that this special rule also applies for purposes of the employer shared responsibility rules.

On Sept. 13, 2013, the Department of Labor (DOL) issued [Technical Release 2013-03](#), which provides detailed guidance on when an HRA will be considered integrated with other group health coverage. This guidance is generally effective for plan years beginning on or after Jan. 1, 2014, although it may be applied for all prior periods. It is not required that the HRA and the coverage with which it is integrated:

- Share the same plan sponsor or the same plan document or governing instruments; or
- File a single Form 5500, if applicable.



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The Technical Release contains the following guidance on including HRA contributions in determining affordability for purposes of the premium tax credit:

- 1** Even if an HRA is integrated with a plan offered by another employer for purposes of the ACA's annual dollar limit prohibition and preventive services requirement, the HRA does not count toward the affordability or minimum value of the plan offered by the other employer.
- 2** Additionally, if an employer offers an HRA on the condition that the employee does not enroll in non-HRA coverage offered by the employer and instead enrolls in non-HRA coverage from a different source, the HRA does not count in determining whether the employer's non-HRA coverage satisfies either the affordability or minimum value requirement.

According to Notice 2015-87, employer contributions to an HRA count toward an employee's required contribution only to the extent that the amount of the employer's annual HRA contribution is either **required under the terms of the arrangement**, or is **otherwise determinable within a reasonable time before the employee must decide whether to enroll in the eligible employer-sponsored plan**.

A contribution that meets this requirement relates to the immediately subsequent period of coverage for which the employee could enroll and use the HRA contribution. For purposes of the employer shared responsibility rules and the related reporting under Section 6056, the employer contribution to an HRA (and any resulting reduction in the employee contribution) is treated as made ratably for each month of the period to which it relates.

**Example.** The employee contribution for health coverage under the major medical group health plan offered by the employer is generally \$200/month. For the current plan year, the employer makes newly available \$1,200 under an HRA that the employee may use to: (1) pay the employee share of contributions for the major medical coverage; (2) pay cost-sharing; or (3) pay towards the cost of vision or dental coverage. The HRA satisfies all requirements for integration with the major medical group health plan.

**Conclusion.** The \$1,200 employer contribution to the HRA **reduces the employee's required contribution for the coverage**. For purposes of the employer shared responsibility rules and the related reporting under Section 6056, the employee's required contribution for the major medical plan is \$100 (\$200 - \$100) per month because 1/12 of the \$1,200 HRA amount per month is taken into account as an employer contribution, whether or not the employee uses the HRA to pay the employee share of contributions for the major medical coverage.

## Wellness Program Incentives

Also, according to the November 2014 individual mandate final regulations, 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.

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Wellness program incentives are not addressed in Notice 2015-87. However, [final regulations](#) on minimum value, published on Dec. 18, 2015, reiterate that, for purposes of affordability:

- Wellness incentives **unrelated to tobacco** use are treated as **unearned**; and
- Wellness incentives **related to tobacco** use are treated as **earned**.

## Opt-out Payments

On July 8, 2016, the IRS issued [proposed regulations](#) addressing the effect of opt-out payments on the affordability of employer-sponsored coverage.

An **opt-out payment** is defined as a payment made by an employer to an employee that:

- Is available only if the employee declines coverage (which includes waiving coverage in which the employee would otherwise be enrolled) under the employer-sponsored plan; and
- Cannot be used to pay for coverage under the employer-sponsored plan.

The arrangement under which the opt-out payment is made available is known as an **opt-out arrangement**. An amount provided as an employer contribution to a Section 125 cafeteria plan that may be used by the employee to purchase minimum essential coverage **is not an opt-out payment**, whether or not the employee may receive the amount as a taxable benefit.

The proposed regulations generally adopt the approach described in Notice 2015-87. Under this guidance, whether an opt-out payment will need to be counted toward affordability depends on whether the payment is made under a conditional or an unconditional opt-out arrangement.

### Conditional opt-out arrangement

An opt-out arrangement under which payments are conditioned not only on the employee declining employer-sponsored coverage, but also on the satisfaction of one or more additional meaningful conditions (such as the employee providing proof of enrollment in coverage provided by a spouse's employer or other coverage).

### Unconditional opt-out arrangement

An arrangement providing payments conditioned solely on an employee declining employer-sponsored coverage, and not on an employee satisfying any other meaningful requirement related to the provision of health care to employees (such as a requirement to provide proof of coverage through a plan of a spouse's employer).

## Unconditional Opt-out Arrangements

Under the proposed regulations, opt-out payments made available to an employee under an **unconditional opt-out arrangement** will increase an employee's required contribution beyond the amount of salary reduction elections. Thus, the employee's required contribution would be equal to:

The amount the employee is otherwise required to pay for health coverage



The amount of the opt-out payment that the employee must forgo as a result of electing coverage



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For example, if an employer offers employees group health coverage through a Section 125 cafeteria plan, requiring employees who elect self-only coverage to contribute \$200 per month toward the cost of that coverage, and offers an additional \$100 per month in taxable wages to each employee who declines the coverage, Notice 15-87 provides that **the offer of \$100 in additional compensation has the economic effect of increasing the employee's contribution for the coverage.**

In this case, the employee contribution for the group health plan effectively would be \$300 (\$200 + \$100) per month, because an employee electing coverage under the health plan must forgo \$100 per month in compensation in addition to the \$200 per month in salary reduction.

This guidance is proposed to take effect for taxable years beginning after Dec. 31, 2016, once final regulations are issued and become applicable. Before final regulations are issued, opt-out payments generally will not be treated as increasing an employee's required contribution for purposes of the employer shared responsibility rules and the related reporting requirements under Section 6056.

**However, the IRS plans to apply these rules beginning Dec. 16, 2015, for any opt-out arrangements that are adopted after Dec. 16, 2015.** For this purpose, an opt-out arrangement will be treated as adopted after Dec. 16, 2015, unless:

- 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 Dec. 16, 2015;
- A board, committee or similar body, or an authorized officer of the employer specifically adopted the opt-out arrangement before Dec. 16, 2015; or
- The employer had provided written communications to employees on or before Dec. 16, 2015, indicating that the opt-out arrangement would be offered to employees at some time in the future.

The proposed regulations clarify that this includes an unconditional opt-out arrangement that is required under the terms of a collective bargaining agreement (CBA) in effect before Dec. 16, 2015. As a result, employers participating in the CBA are not required to increase the amount of an employee's required contribution by amounts made available under the opt-out arrangement for purposes of the employer shared responsibility rules or Section 6056 reporting until the later of:

- The beginning of the first plan year that begins following the expiration of the CBA in effect before Dec. 16, 2015 (disregarding any extensions on or after Dec. 16, 2015); or
- The applicability date of these regulations with respect to the employer shared responsibility rules and Section 6056 reporting.

This treatment will apply to any successor employer adopting the opt-out arrangement before the expiration of the CBA in effect before Dec. 16, 2015 (disregarding any extensions on or after Dec. 16, 2015).

## Conditional Opt-out Arrangements

According to the proposed regulations, the effect of the availability of a **conditional opt-out payment** is less clear. In particular, under an unconditional opt-out arrangement, an individual who enrolls in the employer coverage loses the opt-out payment as a direct result of enrolling in the employer coverage. By contrast, in the case of a conditional opt-out arrangement, the availability of the opt-out payment may depend on information that is not generally available to the

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employer (who, if it is an ALE, must report the required contribution under Section 6056 and whose potential employer shared responsibility liability may be affected).

In an effort to provide a workable rule, the proposed regulations provide that amounts made available under **conditional opt-out arrangements** are disregarded in determining the required contribution only if the arrangement satisfies certain conditions (that is, it is an eligible opt-out arrangement). For this purpose, an **eligible opt-out arrangement** is an arrangement under which the employee's right to receive the opt-out payment is conditioned on:

- The employee declining to enroll in the employer-sponsored coverage; and
- The employee annually providing reasonable evidence that the employee and the employee's expected tax family have or will have minimum essential coverage (other than coverage in the individual market) during the period of coverage to which the opt-out arrangement applies.

For example, if an employee's expected tax family consists of the employee, the employee's spouse and two children, the employee would meet this requirement by providing reasonable evidence that the employee, the employee's spouse and the two children will have coverage under the group health plan of the spouse's employer for the period to which the opt-out arrangement applies.

The IRS invites comments on this proposed rule, including suggestions for other workable rules that result in the required contribution more accurately reflecting the individual's cost of coverage while minimizing undesirable consequences and incentives.

## Fringe Benefit Payments for Federal Contract Workers

The Service Contract Act (SCA) and the Davis-Bacon Act (DBA) require federal contract workers to be paid prevailing wages and fringe benefits, which often may be cashed out. According to Notice 15-87, the IRS continues to consider how the SCA, the DBA and the employer shared responsibility rules may be coordinated.

Notice 15-87 provided that, until further guidance is issued (at least through 2016 plan years), for purposes of the employer shared responsibility rules and the Section 6056 reporting requirements, employer fringe benefit payments (including flex credits or contributions) under the SCA or DBA that may be used to pay for coverage under an eligible employer-sponsored plan will be treated as **reducing the employee's required contribution**, but only to the extent it does not exceed the amount required under the SCA or DBA.

On March 30, 2016, the DOL issued [All Agency Memorandum 220](#) (AAM 220), along with [FAQs](#), to provide additional guidance on how the ACA interacts with the SCA and DBA.

*Source: Internal Revenue Service*