



# Health Care Reform

## LEGISLATIVE BRIEF

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## Employer Penalties – Affordability Safe Harbors

Beginning in 2014, the Affordable Care Act (ACA) imposes “pay or play” requirements on large employers. Under these “pay or play” requirements, large employers that do not offer health coverage to their full-time employees and their dependents, or that offer coverage that is either unaffordable or does not provide minimum value, may be subject to a penalty. This penalty is also referred to as a “shared responsibility payment.”

On Jan. 2, 2013, the Internal Revenue Service (IRS) published [proposed regulations](#) that provide further guidance on whether coverage will be considered affordable. The IRS previously announced the Form W-2 safe harbor, which allows employers to assess affordability for each employee according to the employee’s Form W-2 wages only (rather than household income). The proposed regulations:

- Incorporate the Form W-2 safe harbor; and
- Establish two additional affordability safe harbors: the **rate of pay safe harbor** and the **federal poverty line safe harbor**.

The regulations are not final. However, employers may rely on the proposed regulations until final regulations or other applicable guidance is issued.

This Wine Sergi & Company LLC Legislative Brief describes the three affordability safe harbors that employers may use to determine whether their health coverage is affordable.

### BACKGROUND

The affordability of any health coverage offered by a large employer is a key point in determining whether the employer will be subject to a shared responsibility penalty. The 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. “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 employers may be largely unaware of the income levels of their employees’ family members, they could find it difficult to assess whether the coverage they offer would be considered affordable. To address this issue, the three affordability safe harbors provide alternate methods of determining the affordability of their health coverage.

### *Safe Harbor Application*

The proposed rules clarify that the affordability safe harbors apply only for purposes of determining whether an employer’s coverage satisfies the 9.5 percent affordability test for purposes of the shared responsibility penalty under Code section 4980H(b). The safe harbors do not affect an employee’s eligibility for a premium tax credit, which would continue to be 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 (based on W-2 wages) for purposes of determining whether the employer is subject to a penalty and the same offer of coverage could be treated as unaffordable (based on household income) for purposes of determining whether the employee is eligible for a premium tax credit.



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## 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. The proposed rules emphasize that wages for the purposes of the Form W-2 safe harbor *does not take into account* any elective deferrals to a 401(k), 403(b) or cafeteria plan.

### **Eligibility for the Form W-2 Safe Harbor**

To be eligible for the Form W-2 safe harbor, an employer must:

- Offer its full-time employees (and their dependents) the opportunity to enroll in minimum essential coverage under an employer-sponsored plan; and
- Ensure that the employee portion of the self-only premium for the employer's lowest cost coverage that provides minimum value (the employee contribution) does not exceed 9.5 percent of the employee's W-2 wages.

If the employer satisfies both of these requirements for a particular employee, along with any other conditions for the safe harbor, the employer will not be subject to a penalty for providing unaffordable coverage with respect to that employee. This is the case even if the employee receives a premium tax credit or cost sharing reduction to purchase coverage through a health insurance exchange.

### **Timing of the Form W-2 Safe Harbor**

Whether the safe harbor applies will be determined after the end of the calendar year and on an employee-by-employee basis, taking into account W-2 wages and employee contributions. However, an employer could also use the Form W-2 safe harbor prospectively, at the beginning of the year, by structuring its plan and operations to set the contribution for each employee at a level that would not exceed 9.5 percent of that employee's W-2 wages for that year. Employers may also make adjustments for pay periods so that the employee contribution does not exceed 9.5 percent of the employee's W-2 wages.

### **Form W-2 Safe Harbor for New Employees**

For an employee who was not a full-time employee for the 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. The adjusted wages will then be compared to the employee share of the premium during that period.

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 months the employee was employed. That adjusted wage amount is then compared to the employee share of the premium for the months that coverage was offered to determine whether the Form W-2 safe harbor was satisfied for that employee.

## RATE OF PAY SAFE HARBOR

The rate of pay safe harbor was designed to be easy to apply and 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 hourly rate of pay for each hourly employee who is eligible to participate in the health plan as of the beginning of the plan year;
- Multiply that rate by 130 hours per month (the benchmark for full-time status for a month); and
- Determine affordability based on the resulting monthly wage amount.

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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 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). **For salaried employees**, monthly salary would be used instead of hourly salary multiplied by 130 hours.

An employer may use the rate of pay safe harbor only if, with respect to the employees for whom the employer applies the safe harbor, the employer did not reduce the hourly wages of hourly employees, or the monthly wages of salaried employees, during the year.

### **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 a premium tax credit because of their income level or eligibility for Medicare, and therefore cannot trigger an employer's liability for a shared responsibility penalty).

Specifically, employer-provided coverage offered to an employee is considered affordable if the employee's cost for self-only coverage under the plan does not exceed 9.5 percent of the FPL for a single individual. For households with families, the amount that is considered to be below the poverty line is higher, so using the amount for a single individual ensures that the employee contribution for affordable coverage is minimized. Employers can use the most recently published poverty guidelines as of the first day of the plan year of the applicable large employer member's health plan.

*Source: Internal Revenue Service*