
# How the 2020 ACA Affordability Decrease to 9.78% Affects Employers

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*By: Brian Gilmore, Lead Benefits Counsel, VP*

On Tuesday, the IRS issued Revenue Procedure 2019-29, which decreases the affordability threshold for ACA employer mandate pay or play purposes to **9.78%** for plan years beginning in 2020.

- 2015 Percentage: 9.56%
- 2016 Percentage: 9.66%
- 2017 Percentage: 9.69%
- 2018 Percentage: 9.56%
- 2019 Percentage: 9.86%
- **2020 Percentage: 9.78%**

After 2019 brought the largest increase (by far) in the affordability percentage since the ACA employer mandate pay or play rules took effect, we have now moved downward again for 2020. The affordability percentage decreased based on the ACA's index inflation metric, which is the rate of premium growth for the preceding year over the rate of CPI growth for the preceding year.

Although the Revenue Procedure refers only to eligibility thresholds for Exchange subsidies (the §36B premium tax credit), the IRS confirmed in IRS Notice 2015-87 (frequently referred to as the "ACA Potluck Guidance") that the employer mandate pay or play affordability safe harbors are indexed for inflation in the same manner as affordability is determined on the Exchange.

The affordability percentages apply for plan years beginning in the listed year (i.e., a calendar plan year will have the 9.78% affordability threshold for the plan year beginning January 1, 2020).

<u>Which Employers Need to Worry About ACA Affordability?</u>
The ACA employer mandate pay or play rules apply to employers that are "Applicable Large Employers," or "ALEs." In general, an employer is an ALE if it (along with any members in its

controlled group) employed an average of at least 50 full-time employees, including full-time equivalent employees, on business days during the preceding calendar year.

For more details on how to determine if an employer qualifies as an ALE, see our summary: Becoming and ALE Subject to the ACA Employer Mandate.

ALEs are receiving IRS Letters 226J informing them of ACA employer mandate pay or play penalty assessments under both the A Penalty and B Penalty (described below). These assessments can be very large.

**ACA employer mandate pay or play penalties are now very real!**

Why Does it Matter if an ALE Offers "Affordable" Coverage?
There are two potential ACA employer mandate pay or play penalties.

a) **IRC §4980H(a)—The "A Penalty"**

The first is the §4980H(a) penalty—frequently referred to as the "A Penalty" or the "Sledge Hammer Penalty." This penalty applies where the ALE fails to offer minimum essential coverage to at least 95% of its full-time employees in any given calendar month.

The 2019 A Penalty is projected to be $208.33/month ($2,500 annualized) multiplied by all full-time employees (reduced by the first 30). It is triggered by at least one full-time employee who was not offered minimum essential coverage enrolling in subsidized coverage on the Exchange.

The A Penalty is ***not*** affected by whether the ALE's offer of minimum essential coverage is affordable to the employee. A Penalty liability is focused solely on whether the employer offered a major medical plan to a sufficient percentage of full-time employees—not whether that offer was affordable (or provided minimum value).

a) **IRC §4980H(b)—The "B Penalty"**

The second is the §4980H(b) penalty—frequently referred to as the "B Penalty or the "Tack Hammer Penalty." This penalty applies where the ALE is ***not*** subject to the A Penalty (i.e., the ALE offers coverage to at least 95% of full-time employees). It applies for each full-time employee who was not offered minimum essential coverage, offered unaffordable coverage, or offered coverage that did not provide minimum value **and** was enrolled in subsidized converge on the Exchange.

The 2019 B Penalty is projected to be $312.50/month ($3,750 annualized). Unlike the A Penalty, the B Penalty multiplier is only those full-time employees not offered coverage (or offered unaffordable or non-minimum value coverage) who actually enrolled in the Exchange. The multiple is not all full-time employees.

In other words, an ALE who offers minimum essential coverage to a full-time employee will be subject to the B Penalty if a) the coverage does not provide minimum value ***or is not affordable***, and b) the full-time employee declines the offer of coverage and instead enrolls in subsidized coverage on the Exchange.

**Therefore, an ALE's failure to offer coverage that meets the ACA affordability standard for any given full-time employee creates a projected potential 2019 employer mandate pay or play B Penalty liability of $312.50/month ($3,750 annualized) for that full-time employee.**

For more details on the A Penalty and the B Penalty, see slide 9 of our ABD Office Hours webinar session 2018 Year In Review: Plus What Lies Ahead in 2019.

How Does the ACA Affordability Test Work?

The ACA affordability test is based on the employee-share of the premium for employee-only coverage under the ALE's lowest cost plan option in which the employee is eligible to enroll (that provides minimum value) at the employee-only coverage tier. In other words, you look to the lowest possible amount that an employee could pay to enroll in the employer's major medical plan.

Employers that offer different medical plan options to different groups of employees will need to look to the lowest cost plan option available to each particular employee group to determine affordability. This issue most commonly arises for employers with different regional coverage for employees in various states. For example, the lowest cost plan option may be a regional HMO in California that is not available to employees in other states. In that situation, the affordability analysis for employees in the other states (who are not eligible for the CA regional HMO) is based on the lowest cost plan option available to those particular employees.

The affordability test technically looks to whether that lowest possible employee contribution is within 9.5% (indexed for inflation) of the employee's household income. However, the IRS recognizes that employers generally do not know the employee's household income.

Therefore, the IRS provides ***three safe harbors*** for ALEs to determine whether an offer of coverage is affordable for purposes of avoiding B Penalty liability:

1) **Federal Poverty Line Affordability Safe Harbor**
2) **Rate of Pay Affordability Safe Harbor**
3) **Form W-2 Affordability Safe Harbor**

If an ALE's offer meets any of these safe harbors, the offer of coverage is deemed affordable for B Penalty purposes—regardless of whether the employee may qualify for Exchange subsidies based on the employee's actual income and number of household members.

The affordability status of an offer is not affected by an employee electing to enroll in coverage other than the lowest possible employee contribution amount. For example, if an employee chooses the highest-cost family plan coverage option, the offer's affordability status is still determined by reference to the lowest cost employee-only coverage option that was available to the full-time employee.

May an ALE Use More than One Affordability Safe Harbor?

Yes, the ALE may choose different safe harbors for any reasonable category of employees. However, the caveat is that the ALE must apply each safe harbor on a uniform and consistent basis for all employees in each category.

The IRS states that reasonable categories include specified job categories, nature of compensation (such as salaried or hourly), geographic location, and similar bona fide business criteria. Listing employees specifically by name (or other categories having the same effect) is not considered a reasonable category.

1) The Federal Poverty Line Affordability Safe Harbor

**Action Item: Always use this safe harbor if it is available!**

An ALE's coverage will be automatically deemed affordable for all full-time employees if the offer meets the federal poverty line affordability safe harbor.

In order to qualify, the employee-share of the premium for the ALE's lowest cost plan option (which provides minimum value) at the employee-only coverage tier cannot exceed 9.78% (2020) of the continental U.S. federal poverty line for a single individual that is in effect within six months before the first day of the plan year, divided by 12.

The 2019 federal poverty line for a single individual in the continental U.S. is $12,490.

**Accordingly, for calendar plan years, the 2020 federal poverty line affordability safe harbor applies where the lowest possible employee contribution for the major medical plan does not exceed $101.79.**

- 2015 Federal Poverty Line Limit: $92.97
- 2016 Federal Poverty Line Limit: $94.74
- 2017 Federal Poverty Line Limit: $95.93
- 2018 Federal Poverty Line Limit: $96.08
- 2019 Federal Poverty Line Limit: $99.75
- **2020 Federal Poverty Line Limit: $101.79**

**Action Item: As you begin to plan contribution strategies for the 2020 plan year, consider offering a plan option that costs full-time employees no more than $101.79/month.**

*ACA Reporting Under the Federal Poverty Line Safe Harbor*

ALEs meeting the federal poverty line affordability safe harbor may utilize the **Qualifying Offer Method** (provided the offer of coverage was made available to the employee's spouse and dependents, if any).

Under the Qualifying Offer Method, the employer does not complete Line 15 of the full-time employee's Form 1095-C. This streamlined reporting option is available because the monthly employee-share of the premium for the lowest cost plan at the employee-only tier is not relevant for B Penalty purposes where coverage is deemed affordable for all employees under the federal poverty line affordability safe harbor.

The employer must check the "Qualifying Offer Method" box in Line 22 (Box A) of the Form 1094-C to take advantage of this approach. For full-time employees who are offered coverage, the employer will list Code "1A" (qualifying offer) in Line 14 of the full-time employee's Form 1095-C.

If the employee waives coverage, the employer generally will enter Code "2G" (federal poverty line affordability safe harbor) in Line 16 to confirm that no B Penalty could apply for the full-time employee. The Forms 1094-C and 1095-C Instructions state the employer "may, but is not required to, enter an applicable code on line 16 for any month for which code 1A is entered on line 14," generally recognizing that the qualifying offer code in Line 14 already embeds the federal poverty line affordability report that is redundant in Line 16. Employees who enroll in the offer of coverage will generally have Code "2C" (enrolled in offer of health coverage) because the enrolled code takes precedence over the affordability safe harbor codes for Line 16.

**<u>Action Item</u>: If you meet the federal poverty line affordability safe harbor, take advantage of the Qualifying Offer Method for streamlined ACA reporting via Forms 1094-C and 1095-C.**

(Note that the Qualifying Offer Method also permits ALEs to provide a substitute form—in place of the standard Form 1095—to full-time employees who received a qualifying offer for all 12 months of the calendar year and were not enrolled in self-insured coverage. We generally do not recommend this substitute form approach because the employer is still required to provide the Form 1095-C to the IRS.)

2) <u>The Rate of Pay Affordability Safe Harbor</u>

**Action Item: In most cases, ALEs that do not meet the federal poverty line affordability safe harbor will want to use the rate of pay affordability safe harbor.**

The rate of pay affordability safe harbor applies the applicable affordability percentage based on two separate tests—one for hourly full-time employees, and one for salaried full-time employees.

- <u>Hourly Full-Time Employees</u>
  ***Test:*** **9.78% (2020) of the employee's hourly rate of pay as of the first day of the coverage period x 130 hours**

  *Note: The hourly rate of pay is multiplied by 130 regardless of actual hours of service performed. The IRS uses 130 hours of service in a calendar month as a proxy for the 30 hours of service/week full-time status definition in §4980H.*

  *Example:*
  - Widget Co.'s lowest paid full-time hourly employees are paid at a rate of $10/hour for each calendar month in 2020
  - 130 hours of service x $10/hour = $1,300 assumed monthly income
  - Full-time employee monthly contribution rate for lowest-cost, employee-only coverage cannot exceed 9.78% (2020) of $1,300
  - $1,300 x. .0978 = **$127.14/month maximum**

- <u>Salaried Full-Time Employees</u>
  ***Test:*** **9.78% (2020) of the employee's monthly salary as of the first day of the coverage period**

  *Note: Special rules apply if the employee's hourly rate or monthly salary is reduced.*

  *Example:*
  - Widget Co.'s lowest paid full-time salaried employees are paid a salary of $30,000 in 2020
  - $30,000 / 12 = $2,500 monthly salary
  - Full-time employee monthly contribution rate for lowest-cost, employee-only coverage cannot exceed 9.78% (2020) of $2,500

- $2,500 x .0978 = **$244.50/month maximum**

**Action Item: An ALE will meet the rate of pay affordability safe harbor for all full-time employees if the employee-share of the premium for the lowest-cost plan at the employee-only tier does not exceed these monthly maximum thresholds.**

In the examples above, Widget Co.'s plan would be affordable for all full-time employees (hourly and salaried) if the lowest possible amount that an employee could pay to enroll in the employer's major medical plan does not exceed $127.14/month.

*ACA Reporting Under the Rate of Pay Safe Harbor*
If the employee waives coverage, the employer will enter Code "2H" (rate of pay affordability safe harbor) in Line 16 to confirm that no B Penalty could apply for the full-time employee. Employees who enroll in the offer of coverage will always have Code "2C" (enrolled in offer of health coverage) because the enrolled code takes precedence over the affordability safe harbor codes for Line 16.

3) <u>The Form W-2 Affordability Safe Harbor</u>

**Action Item: This is generally the least desirable affordability safe harbor. Most employers will want to attempt to meet the federal poverty line or rate of pay affordability safe harbors before assessing the Form W-2 affordability safe harbor.**

The Form W-2 affordability safe harbor provides that coverage is affordable if the employee-share of the premium for the lowest cost plan option at the employee-only tier does not exceed 9.78% (2020) of the employee's Box 1 wages on the Form W-2.

This approach has several disadvantages:

- **Disadvantage #1:** The Form W-2 affordability safe harbor provides little predictability because employees' Box 1 wages are unknown until January of the following year. For example, an ALE would not know until January of 2021 whether it met the Form W-2 affordability safe harbor for any full-time employee in 2020.

- **Disadvantage #2:** Box 1 of the Form W-2 does not include many common forms of compensation, including 401(k)/403(b)/457(b) employee deferrals and Section 125 salary reductions for health and welfare plan coverage and FSA/HSA contributions. This can result in a significantly reduced Box 1 amount from an ALE's expectation for any given full-time employee.

- **Disadvantage #3:** The employee-share of the premium must remain consistent as an amount or percentage for the full plan year. This means that employers cannot make mid-year adjustments to address lower-than-anticipated Box 1 amounts.

In short, the Form W-2 affordability safe harbor is probably well suited only for employers that impose an employee contribution amount based on a fixed percentage of Form W-2 wages throughout the year. However, most ALEs do not structure contribution tiers in this manner—thereby limiting the Form W-2 affordability safe harbor as a viable contender to only a select few employers.

**Action Item: Consider creating a fixed percentage-based contribution structure if you are going to rely on the Form W-2 affordability safe harbor.**

*ACA Reporting Under the Form W-2 Safe Harbor*
If the employee waives coverage, the employer will enter Code “2F” (Form W-2 affordability safe harbor) in Line 16 to confirm that no B Penalty could apply for the full-time employee. Employees who enroll in the offer of coverage will always have Code “2C” (enrolled in offer of health coverage) because the enrolled code takes precedence over the affordability safe harbor codes for Line 16.

How Do Flex Credits Affect the Affordability Determination?
Flex credits will reduce the dollar amount of the employee-share of the cheapest plan option providing minimum value that is used to determine affordability if they meet a three-part test to qualify as a “health flex contribution”:

1) The employee may not opt to receive the amount as a taxable benefit (i.e., it is not a cashable flex credit);
2) The employee may use the amount to pay for minimum essential coverage (i.e., the employer’s major medical plan); **and**
3) The employee may use the amount exclusively for medical/dental/vision coverage costs.

**Action Item: If you offer a defined contribution-style flex credit approach to employees, make sure that a sufficient portion are designated as “health flex contributions” to qualify under an affordability safe harbor. This will require at least some of the flex credits be non-cashable and designated for health plan purposes only.**

For more details, see our summary How the ACA Affects Flex Credits.

How Do Opt-Out Credits Affect the Affordability Determination?
The general rule is that the amount of the opt-out credit must be added to the employee-share of the cheapest plan option providing minimum value that is used to determine affordability.

*Example:* The employee-share of the premium for the employer’s cheapest plan option providing minimum value is $75/month for employee-only coverage. The plan offers a $25/month opt-out credit for employees who decline enrollment. Under the general rule, the plan costs $100/month ($75/month premium plus $25 opt-out credit) for purposes of the affordability rules to reflect the $25/month an employee forgoes when electing to enroll.

To avoid the need to add the opt-out credit amount to the cost of the plan, the opt-out credit must meet the definition of an “eligible opt-out arrangement,” which requires:

1) The opt-out credit is conditioned on the employee declining to enroll in the major medical plan; and
2) The opt-out credit is conditioned on the employee providing reasonable evidence (including an employee attestation) annually that the employee and all members of the employee’s expected tax family have or will have minimum essential coverage under a group health plan during the period of coverage to which the opt-out credit applies.

*Note: In late 2016, the IRS indefinitely delayed these eligible opt-out arrangement rules for opt-out credits in place prior to December 16, 2015.*

**Action Item: If you are adding an opt-out credit, make sure that you follow these eligible opt-out arrangement conditions to ensure that the opt-out credit does not affect whether your offer of coverage meets an affordability safe harbor.**

For more details, see or our ABD Alert Opt-Out Credits May Affect Pay or Play Affordability Calculations.

Summary

As with just about everything related to the ACA, the affordability determination under the employer mandate pay or play rules is complex.

So to simplify and summarize in a few simple steps:

- Plan ahead,
- Follow an affordability safe harbor,
- Report properly, and
- Avoid those nasty IRS Letters 226J that are informing employers of penalty assessments!