Affordable Care Act

December 2014

Safe Harbors for the Affordability Aspect

Effective January 2015, the Affordable Care Act (ACA) requires employers to offer affordable health insurance to employees who work an average of 30 hours per week over a defined measurement period. The Act also requires the cost of the health insurance to be affordable. The Internal Revenue Service (IRS) has defined affordable coverage as the employee's cost of the insurance not exceeding 9.5% of the employee's household income. As the employer will generally not know the employee's total household income, the IRS has set forth three separate optional safe harbors under which an employer could determine affordability. The IRS safe harbors for affordability are: W-2 wages, rate of pay, and federal poverty level. An employer may choose one or more of these safe harbors for all of its employees or any reasonable category of employees, provided it does so in a reasonable and consistent basis for all employees in a category. Regulation 26 CFR 54.4890H-5(e)(2)(i) provides that "an applicable large employer member may choose to apply the safe harbors for any reasonable category of employees, provided it does so on a uniform and consistent basis for all employees in a category. Reasonable categories generally include specified job categories, nature of compensation (hourly or salary), geographic location, and similar bona fide business criteria. An enumeration of employees by name or other specific criteria having substantially the same effect as an enumeration by name is not considered a reasonable category."

The safe harbors are defined in the Federal Register Vol. 79, No. 29, February 12, 2014. An abbreviated definition from that document is listed below.

1) Form W-2 Wages – The employer may calculate the affordability of the coverage based solely on the wages paid to the employee by that employer as reported in Box 1 of the Form W-2 (Wage and Tax Statement) of the current year. The determination is made after the close of the calendar year and on an employee by employee basis. To qualify for this safe harbor, the employee's contribution must remain a consistent dollar amount or percentage of all W-2 wages during the calendar year. For employees not offered coverage for the entire calendar year, the safe harbor is applied by adjusting the W-2 wages to reflect the period for which coverage was offered.

2) Rate of Pay – The rate of pay safe harbor provides employers with a design-based method for satisfying affordability without having to analyze each employee's wages and hours. For an hourly employee, the employer uses an assumed rate of 130 hours per calendar month (regardless of whether the employee works more or less than 130 hours in a calendar month) multiplied by the lower of: (1) the employee's hourly rate of pay as of the first day of the plan year, or (2) the employee's hourly rate of pay during the calendar month. The rate of pay safe harbor can be used for salaried employees if the employee's required contribution for the calendar month for the lowest cost self-only coverage doesn't exceed 9.5% of the employee's monthly salary, as of the first day of the coverage period (instead of 130 multiplied by the hourly

rate of pay). However, this safe harbor is not available for exempt employees if the monthly salary is reduced, including due to a reduction in work hours.

3) Federal Poverty Line – Under this safe harbor the employee's contribution is considered affordable if the employee's contribution for the calendar month for the lowest self-only coverage doesn't exceed 9.5% of a monthly amount determined as the federal poverty line for a single individual for the applicable calendar year, divided by 12. This provides employers a predetermined maximum amount of employee contribution that in all cases will result in coverage being deemed affordable. When using the Federal Poverty Line safe harbor, employers must set the rate of the employee contribution on the first day of the plan or no earlier than six months prior. Allowing employers the administrative convenience of setting the employee contribution rates up to six months prior to the first day of plan enables adequate time to establish premium amounts in advance of the plan's open enrollment.

One safe harbor may not work best for all employee categories, or for all institutions. There are advantages and disadvantages to each of the safe harbors. To assist the administration at each institution with determining the safe harbor(s) that will work best given their employment/payroll scenarios and employee categories, the following points of interest for each safe harbor are provided.

W-2 Wages	Rate of Pay	Federal Poverty Level
Can be used for exempt and non-exempt employees	Can be used for exempt and non-exempt employees, as long as monthly salary is not reduced for exempt employees	Can be used for exempt and non-exempt employees
Application is determined after the calendar year on an employee-by-employee basis.	Can be used for hourly employees even if pay is reduced, as calculated on monthly basis.	Application is known in advance by using the most recent Federal Poverty Guidelines for a single individual for applicable calendar year.
Doesn't take into consideration any pre-tax deductions. Employees with same wages and healthcare premiums could have different results depending on pretax deductions.	Unavailable for salaried employees if the employer reduced the wages of the employee.	
For employees who do not work the entire year, the wages must be adjusted by multiplying by the number of months coverage was offered.	The monthly salary for salaried employees would be used instead of hourly salary multiplied by 130.	

Examples		
Employee W is employed February 1, 2015 and is offered coverage beginning November 1, 2015. The employee required contribution for the lowest cost self-only coverage is $114/calendar month. The wages in Box of the W-2 for 2015 are multiplied by 2/11. (2 months of coverage over 11 months of employment during the calendar year.) Affordability is determined by comparing the adjusted W-2 wages to the employee's required contribution for the period coverage was offered.	Employee R is employed for full year of 2015. The employee contribution is $114/calendar month. Employee R is paid $9.50/hour for the entire year. The employer multiplies 130 hours of service by $9.50 = $1235 X 9.5% ($117.32) and compares it against employee contribution of $114/month. Because the employee's contribution is less than 9.5% it is considered affordable.	Employee F is employed for all of 2015 with coverage. The employee contribution for the lowest-cost single coverage is set at $92.00 at the beginning of the plan year. Employee F has 3 weeks of unpaid time off in May and another 2 weeks off, unpaid in December. If the FPL is $11,670 for 2015, the employer multiplies 9.5% by $11,670 = $1108.65 and then divides by 12 for a monthly premium of $92.39. Regardless of Employee F's wages for any month, including those with unpaid time off, if the employee is not charged more than $92.39/month it is considered affordable. Since the employee contribution for the lowest-cost single coverage is $92.00, it meets the affordability requirement.
	Employee P is employed for full year of 2015. The employee contribution is $139/calendar month. Employee P is paid $16,575 for the entire year, or $1381.25/month. The employer multiplies monthly salary X 9.5% ($131.22) and compares it against employee contribution of $139/month. Because the employee's contribution is more than 9.5% it is not considered affordable and a subsidy to cover the difference may be appropriate.	