COMPLIANCE INSIGHTS

Alliant EMPLOYEE BENEFITS

An In-Depth Look at Affordability under Pay or Play

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Overview

Under final Pay or Play rules an Applicable Large Employer (ALE) can face significant "part (a)" penalties if they do not offer Minimum Essential Coverage (MEC) to substantially all of their full-time employees ($2,000 for every full-time employee minus 30 – penalty shown annualized and not indexed).[1] If an ALE offers coverage to full-time employees they can still face penalties for full-time ineligible employees and/or if the coverage they offer is "unaffordable" or is not at least a 60% minimum value plan ($3,000 per full-time employee who receives subsidized Exchange coverage – penalty shown annualized and not indexed)—the "part (b)" penalty. "Unaffordable" under the Pay or Play provision of the ACA is defined as an employee being asked to pay more than 9.5% of their modified adjusted gross household income for the employer's lowest cost minimum value plan at the employee only tier of coverage.[2] This amount was indexed to 9.56% for 2018, 9.86% for 2019, 9.78% for 2020, 9.83% for 2021, 9.61% for 2022, and 9.12% for 2023. Importantly, employees are only eligible for Exchange subsidies if they have a household income above the Medicaid eligibility threshold and between 100% and 400% of the Federal Poverty Level (FPL).[3]

Affordability Safe harbors

Affordability is based on household income and household income is determined by variables that are generally not known to an employer (i.e., the modified adjusted gross income of the employee and the employee's spouse and dependents). As a result, IRS introduced three affordability safe harbors for employers. Use of the safe harbors is optional for employers. Employers may choose to use a safe harbor for any reasonable category of employees, provided it does so on a uniform and consistent basis for all employees in that category. Reasonable categories for this purpose include specified job categories, nature of compensation (hourly or salary), geographic location, and similar bona fide business criteria. If an employer uses one of the safe harbors it will not have part (b) penalties under Pay or Play based on unaffordability. Use of a safe harbor, however, will not prevent an employee from receiving Exchange subsidies if they otherwise qualify for them.

The three affordability safe harbors are: (1) the W-2 safe harbor, (2) the Rate of Pay safe harbor, and (3) the Federal Poverty Level safe harbor. Each safe harbor uses the statutory 9.5% and annual, indexed percentages to determine the affordable employee contribution in a particular year. ***Note***

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[1] Where a statute includes an annual penalty, that amount is often "indexed" to automatically increase or adjust, on an annual basis. For Pay or Play penalties, the Internal Revenue Service (IRS) releases the indexed penalty percentages and dollar amounts.

[2] Note that an employer plan will be considered to be affordable for related individuals (family members) if the cost of employee only coverage does not exceed the specified percentage of the employee's household income even if family coverage is significantly more expensive.

[3] The 400% FPL cap is temporarily waived for 2021 and 2022 calendar years but this is not expected to increase ALE penalty risk.

also that each safe harbor is based on the lowest cost plan at the employee only tier of coverage.

1. Under the W-2 safe harbor, in 2018, employees will not be asked to contribute more than 9.56% of their Form W-2, Box 1 wages. In 2019, that percentage is 9.86% and in 2020 it is 9.78. For 2021 it was increased slightly to 9.83%. For 2022 it was decreased to 9.61% and for 2023 it decreased to 9.12%. This is officially a retrospective determination—the W-2 issued in early 2018 controls for 2017, the W-2 issued in early 2019 controls for 2018, and so on. Although the determination of whether an employer actually satisfied the safe harbor is made after the fact at the end of the calendar year, an employer can generally still use the safe harbor prospectively by structuring its plan and operations to set each employee's contribution at a level that will not exceed the applicable indexed percentage of each employee's W-2 wages for the applicable year. Note that the applicable indexed percentage amounts (9.61% for 2022 and 9.12% for 2023) must be based on W-2 wages minus any pre tax deductions as would be ultimately reflected in Box 1. This option can be effective for employers with higher wage earners that are still within the subsidy eligibility window (below 400% FPL) and will generally be a less expensive contribution structure for employers than using the FPL safe harbor. As noted below, it may also be preferable to the Rate of Pay safe harbor because hours are not capped under the W-2 safe harbor like they are with the Rate of Pay safe harbor (see below).

2. Under the Rate of Pay safe harbor, an employer sets employee contributions based on the employee's rate of pay multiplied by 130 hours in a month (hours are capped regardless of how many hours are actually worked). For 2019, it cannot exceed 9.86% of the employee rate of pay multiplied by 130 hours in a month. For 2020, the contribution cannot exceed 9.78% of that amount. For 2021 it was increased slightly to 9.83%. For 2022 it was decreased to 9.61% and for 2023 it decreased to 9.12%. If an employee's rate of pay is reduced during the year, the rate of pay is applied separately to each calendar month, rather than the entire year, and the employee's required contribution may be treated as affordable if it is affordable based on the lowest rate of pay for the calendar month multiplied by 130 hours. This will likely also be a less expensive contribution structure for employers than the FPL safe harbor but can be difficult to manage if the rate of pay fluctuates. Notably, for non-hourly employees, employers use the employee's monthly salary as of the first day of the month without applying the 130 hour cap on hours but if salary is reduced mid-month the safe harbor is not available for that month. Tips cannot be included in the rate of pay. This safe harbor cannot be used for commissioned employees and should be used with caution for tipped employees.

3. Under the Federal Poverty Level (FPL) safe harbor, contributions are based on 100% of the single FPL <u>in effect 6 months prior to the start of the plan year</u>. 100% of the single FPL for 2018 is $12,140 and for 2019 it is $12,490. For 2020, it increased to $12,760. For 2021 it is $12,880 and for 2022 it is $13,590. Generally this is the simplest safe harbor to administer because employees cannot be asked to pay more than ~$95-103/month (depending on the year) for employee only coverage on the lowest cost plan. Although this is a static and simple safe harbor it is the most expensive for employers in terms of allocating employer and employee cost sharing. The chart below shows how the prior year's FPL sets the safe harbor contribution amount for a calendar year plan. Note that non-calendar year plan years beginning on or after August 1 will need to use the updated FPL released in January.

1/1 Plan Year	2016 PY	2017 PY	2018 PY	2019 PY	2020 PY	2021 PY	2022 PY	2023 PY
Unaffordable %	9.66%	9.69%	9.56%	9.86%	9.78%	9.83%	9.61%	9.12%
100% FPL	$11,770	$11,880	$12,060	$12,140	$12,490	$12,760	$12,880	$13,590
EE Cost Per Mth	$94.74	$95.93	$96.07	$99.75	$101.79	$104.52	$103.14	$103.28

Analyzing Affordability Outside of Safe harbors

Medicaid Expansion States

As noted above, for an employer to have part (b) penalty exposure, ACA full-time employees must enroll in subsidized Exchange coverage. Individuals are only eligible for Exchange subsidies if they have a household income above the Medicaid eligibility threshold and below 400% of the Federal Poverty Level. This means that employees who seek to enroll in subsidized Exchange coverage but have incomes that make them Medicaid eligible will be routed to Medicaid and not trigger part (b) penalties because they ultimately do not enroll in subsidized Exchange coverage. Although Medicaid eligibility was historically limited to low-income children, pregnant women, elderly and disabled individuals, the ACA expanded Medicaid eligibility to all low income adults. The ACA income eligibility threshold for subsidies is 100% of the FPL, but under the ACA states were given the option (after clarifying litigation) to expand Medicaid eligibility to 138% FPL[4]. Currently 32 states have expanded Medicaid eligibility to this higher threshold while 18 states have not. The result of the Medicaid expansion is that although the ACA FPL Affordability safe harbor is based on 100% FPL, in Medicaid expansion states individuals with incomes below 138% FPL will be routed to Medicaid. This means employers in those states can set premium based on 138% FPL and avoid part (b) penalties. Note, however, this approach does not guarantee affordability in the same fashion as the regulatory safe harbors and it does not allow the employer to report on Forms 1095-C, Line 16 that they are using an affordability safe harbor.

- 2017: 9.69% of 100% FPL ($11,880) vs. 9.69% of 138% FPL ($16,394) = cost sharing difference of $95.93/month vs. $132.38/month
- 2018: 9.56% of 100% FPL ($12,060) vs. 9.56% of 138% FPL ($16,642) = cost sharing difference of $96.07/month vs. $132.58/month
- 2019: 9.86% of 100% FPL ($12,140) vs. 9.86% of 138% FPL ($16,753) = cost sharing difference of $99.75/month vs. $137.65/month
- 2020: 9.78% of 100% FPL ($12,490) vs. 9.78% of 138% FPL ($17,236) = cost sharing difference of $101.79/month vs. $140.47/month
- 2021: 9.83% of 100% FPL ($12,760) vs. 9.83% of 138% FPL ($17,609) = cost sharing difference of $104.52/month vs $144.24/month
- 2022: 9.61% of 100% FPL ($12,880) vs. 9.61% of 138% FPL ($17,774) = cost sharing difference of $103.14/month vs $142.33/month
- 2023: 9.12% of 100% FPL ($13,590) vs. 9.12% of 138% FPL ($18,754) = cost sharing difference of $103.28/month vs $142.53 month

Minimum Wage and Wage Ranges

Unaffordability issues are very employer and employee population specific. However, employers can do some basic unaffordability analysis based on minimum wage requirements. If minimum wage in a state is $9.00 per hour and we multiply that wage rate by 130 hours (the ACA FT monthly threshold) we

[4] This percentage is based on 133% plus an income disregard equivalent to five percentage points of the FPL for the applicable family size.

can estimate that most ACA full-time employees must be earning at least $1,170 per month and at least $14,040 per year (if minimum wage was $10/hr ACA FT employee would generally be earning $1,300 per month and $15,600 per year). This means that unaffordability can be estimated as the applicable, indexed percentage of $14,040 for that particular year (9.56% for 2018, 9.86% for 2019, 9.78% for 2020, 9.83% for 2021, 9.61% for 2022, and 9.12% for 2023). This equates to a premium for employee only coverage of $1,239 per year or $106.7 per month in 2023, $1,349 per year or $112 per month in 2022, $1,380 per year or $115 per month in 2021, and $1,373 per year or $114.42 per month in 2020. Although setting employee cost sharing at this amount (above the FPL safe harbor of ~$103/month) is not a guarantee that an employer will not face unaffordability penalties, it significantly reduces the likelihood of unaffordability penalties while allowing the employer to save money through increased employee cost sharing of approximately $5 per month per employee (for 2022 compare $103 to $112 and for 2023 compare $103 to $107). Note that state minimum wages vary but are compiled annually by the Department of Labor for reference here.

Because unaffordability concerns are directly tied to employee populations and wages, employers should also do some analysis of their specific employee wage ranges. Employers can start this analysis by looking at their existing cost sharing strategy and the annual income of its lower wage earners with incomes that likely fall above the Medicaid eligibility threshold. With this basic data employers can evaluate whether there is part (b) penalty risk or alternatively whether there is additional room to reduce the employer's contribution to the cost of coverage with little or limited risk. If an employer's existing cost sharing requires an employee to contribute $200 per month for the lowest cost plan at the employee only tier of coverage that contribution is $2,400 per year. This would be unaffordable only for individuals with an annual household income of less than $24,742 (for 2023). If most or all employees have incomes higher than $24,742 an employer can increase employee cost sharing with limited part (b) risk. For example, if the lowest wage worker earns $36,000 an employer could increase cost sharing just below 9.86% of that wage for 2019 ($3,549 or $296 per month), 9.78% of that wage for 2020 ($3,521 or $293 per month), 9.83% of that wage for 2021 ($3,539 or $295 per month), 9.61% of that wage for 2022 ($3,459 or $288 per month), and 9.12% of that wage for 2023 ($3,283 or $273 per month) with limited (b) penalty exposure.

Conclusion

Employers have numerous considerations in assessing employee benefit options and employee cost sharing. Affordability safe harbors offer a guarantee against part (b) penalties under Pay or Play based on unaffordability. However, those safe harbors often require significantly increased employer contributions. It is important to balance potential part (b) penalty exposure against the cost to the employer of reducing employee cost sharing (thereby increasing the cost to the employer). As employers look at more advanced unaffordability approaches it is also important to remember that there may be classes of employees that retain their ACA full-time status through a reduction in hours or other decrease in earning. Outside of an affordability safe harbor those employees can create part (b) risk. Ultimately, it is necessary for employers to weigh any potential part (b) risk against an employer's benefits costs to develop a Pay or Play strategy consistent with risk tolerances.