Benefits BRIEF

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Affordability Safe Harbors for ALEs

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Under the Affordable Care Act (ACA), Applicable Large Employers (ALEs) are vulnerable to one of two potential employer shared responsibility penalty assessments. The "Subsection (a) Penalty" applies where the ALE fails to offer minimum essential coverage to at least 95% of its full-time employees (and their dependents) ***and*** at least one full-time employee qualifies for a premium subsidy.

Alternatively, the "Subsection (b) Penalty" applies where the employer meets the 95% offer threshold but fails to offer minimum value, affordable coverage to a full-time employee ***and*** that employee then qualifies for a premium subsidy. Ensuring an offer of coverage is affordable, then, is critical to avoiding the Subsection (b) Penalty.

Using a Safe Harbor

Coverage is deemed affordable for an employee so long as the employee's required contribution for self-only coverage does not exceed a specified percentage of the employee's household income (for 2021, this percentage is ***9.83%***). Because an employer has no way of knowing an employee's household income for purposes of calculating the affordability of coverage, the IRS provides three safe harbors that ALE can use.

If an ALE uses any one of the safe harbors, its offer of coverage will be considered affordable. This is true even if the cost of coverage actually exceeds the specified percentage of the employee's household income. Use of a safe harbor for determining the affordability of minimum value coverage will protect an ALE against the Subsection (b) Penalty.

Three Affordability Safe Harbors

Each of the three safe harbors requires the employer to follow a specified calculation in determining affordability. There are nuances to all three; the following is only a summary explanation.

Federal Poverty Line

The Fedal Poverty Line (FPL) safe harbor requires that the employee's monthly cost for self-only coverage not exceed a specified percentage (9.83% in 2021) of the FPL for a single individual divided by 12.

> ***For example:*** *In 2021, the FPL for a single individual is $12,880. Divided by 12, the monthly equivalent is $1,073.33. In order to use this safe harbor, the monthly cost to the employee for self-only coverage cannot exceed 9.83% of $1,073.33, or approximately $105.50.*

This method is the easiest to apply because it sets a predetermined maximum monthly cost for all employees regardless of income level. However, it typically requires a greater employer contribution. Thus, the greater cost to the employer may outweigh the ease of its application, making it a less attractive option.

Rate of Pay

The rate of pay safe harbor utilizes an employee's hourly or monthly rate of pay in determining affordability. For hourly employees, this method requires the employer to take the employee's hourly rate of pay as of the first day of the plan year and multiply it by 130 hours. For salaried employees, the employer simply uses the employee's monthly salary as of the first day of the plan year.

> ***For example:*** *An employer's lowest-paid employee earns $12 an hour. To ensure an affordable offer of coverage to all employees in 2021, the employer cannot charge employees more than $153.34 per month ($12 multiplied by 130 hours, the product of which is then multiplied by .0983).*

Like the FPL method, ***this safe harbor also provides the employer with a predetermined maximum monthly cost***, but the maximum cost depends upon an employee's hourly rate of pay (or their monthly salary). As a result, the calculation can vary from employee to employee. To avoid this, the employer can instead use its lowest hourly rate of pay (or monthly salary) to determine the maximum monthly employee cost, which will ensure the offer is affordable for all employees.

W-2

The W-2 safe harbor calculates affordability at the end of the year and on an employee-by-employee basis by using the employee's W-2 wages (reported in Box). Under this method, an employee's contribution cannot exceed a specified percentage of their W-2 wages. And importantly, the employee contribution must remain a consistent amount or a consistent percentage of the year's W-2 wages, precluding monthly variations and discretionary adjustments by the employer.

> ***For example:*** *An employer sets the employee monthly cost for coverage at $100 in 2021. At the end of the year, the employer assesses affordability for an employee whose W-2 wages are $24,000. Because $1,200 ($100 multiplied by 12 months) is less than 9.83% of $24,000, the coverage is considered affordable with respect to this employee.*

Unlike the other two methods, this safe harbor does not provide the employer with a predetermined maximum cost to the employee. Instead, affordability is determined at the end of the year based on each employee's W-2 wages. For this reason, ***the W-2 safe harbor is the riskiest to use*** and is best suited for an employer whose employees have a low hourly or monthly rate of pay but a higher taxable income – such as tipped and commissioned employees.

Next Steps

Content ALEs should select one of the three safe harbors to use in determining the affordability of coverage offered to full-time employees (note: an employer may choose to apply a different safe harbor to reasonable categories of employees on a consistent basis). A safe harbor should be used prior to plan renewal each year to set an appropriate – and affordable – premium contribution strategy, and employers should ensure that the chosen method is applied accurately; ***deviations from any of the methods will render the ALE unable to claim the safe harbor***. And finally, when completing the required ACA reporting under Internal Revenue Code Sec. 6056, ALEs should use a Line 16 safe harbor code that corresponds with their chosen method.

ADDITIONAL RESOURCES

Questions and Answers on Employer Shared Responsibility Provisions under the Affordable Care Act

Source: IRS, ALE Info Center