



IRS Proposes "Affordability" Safe Harbor to Benefit Employers

LEGISLATIVE BRIEF

September 22, 2011

In [Notice 2011-73](#) (issued September 13, 2011), the IRS requests comments on its proposed safe harbor for determining the "affordability" of group health coverage offered by a large employer to its full-time employees (and their dependents). The gist of the proposed safe harbor is that:

- For purposes of determining whether an employer is subject to a potential penalty (called an "assessable payment" under IRC section 4980H(b)), the **"affordability of an employer's coverage would be measured by reference to an employee's wages from that employer."** (Specifically, the amount reported in Box 1 of Form W-2.)
- The determination of whether an employee can receive a premium tax credit or cost sharing reduction if the employee buys health insurance in the Exchange would be made in reference to the employee's household income, not to the specific wages the employee earns from that employer.

In both cases, the affordability determination is whether the employee's share of the cost of "self-only" coverage under the employer's plan would be more than 9.5% of applicable income base (either the employee's wages or household income).

The proposed safe harbor benefits employers, but not lower-paid employees. Perhaps anticipated future IRS guidance will ease the effects of the affordability determination for lower-paid employees as well. Additional guidance is expected from the IRS on the shared responsibility and individual mandate provisions of the Patient Protection and Affordable Care Act (PPACA, subsequently referred to as "the Health Care Reform law" or "HCR" in this article).

The "Affordability" Determination Under the Health Care Reform (HCR) Law

Under the HCR law as enacted, employer-provided health coverage is defined as "unaffordable" for a given employee if the employee cost for "self-only" coverage is more than 9.5% of the employee's "household income." Additionally, this affordability determination is applied for two separate purposes:

1. It determines whether the **employer** may be subject to an "assessable payment" (penalty) under IRC section 4980H(b), and also

2. It determines whether an **employee** can receive a premium tax credit if the employee buys health insurance in the Exchange.

The proposed safe harbor would benefit employers by allowing these two separate determinations to be made based on different criteria rather than on the same criteria.

For **employers**, the issue under the HCR language is that they will be subject to a penalty if they offer self-only coverage that is "unaffordable" for an employee and that employee buys coverage in the exchange and receives a tax credit or subsidy. The penalty amount is \$3,000 per year per such employee. Since employers are unlikely to know what an employee's "household income" is, they will be unable to determine whether or not their coverage is "affordable" and whether they might be subject to an assessable payment.

For **employees**, the issue under the HCR language is that the determination of affordability is based on the employee's cost for "self-only" coverage even if the employee actually covers dependents as well. Additionally, an individual who buys coverage through the Exchange is eligible for the tax credit or subsidy only if certain criteria are met. One of these is that the individual must not be eligible for other government coverage or for "affordable" employer coverage. (Other criteria are based on household income level and tax filing status.) The ramification of these two provisions for lower-paid employees who also cover dependents is that the employee share of the cost of family coverage could be quite "unaffordable" even though the cost for self-only coverage is "unaffordable," but the employees would not qualify for a tax credit or subsidy if they bought family coverage through the Exchange.

The Proposed Safe Harbor

Specifically, under the proposed safe harbor an employer will not be subject to the IRC section 4980H(b) "assessable payment" for a particular employee, even if that employee buys insurance through the Exchange and receives a premium tax credit or cost sharing reduction, if:

1. the employer offers its full-time employees (and their dependents) the opportunity to enroll in minimum essential coverage under the employer plan; and
2. the employee portion of the self-only premium for the employer's **lowest cost** option that provides minimum value does not exceed 9.5% of the employee's W-2 wages for that year.

Additionally, the proposed affordability safe harbor would NOT affect an employee's eligibility for a premium tax credit under IRC section 36B. An employee's eligibility for the premium tax credit would continue to be based on the affordability of employer-sponsored "self-only" coverage relative to an employee's household income, not the employee's wages.

How the Proposed Safe Harbor Benefits Employers

This proposed safe harbor benefits employers because they will determine "affordability" based on factors they know and can control (i.e., the wages they pay to each particular employee, as reported on Box 1 of Form W-2). The IRS Notice acknowledges that employers will not know the *actual* amount of employees' W-2 wages until after year-end, but suggests that employers can use the safe harbor prospectively: by projecting what annual wages will be based on what they are at the beginning of the plan year and then structuring their plan and employee contributions based on the expected amounts.

Another important plan design point for employers is that the safe harbor proposes to use the self-only premium for the employer's **lowest cost option** that provides minimum value. Thus, an employer could offer a base option and one or two "buy-up" options, and could not be subject to a penalty if the base option meets the affordability test, even if the higher-cost options do not.

Why Additional Guidance is Needed to Benefit Employees

As noted previously, lower-paid employees with dependents or families have two issues under the original HCR language. Anticipated future guidance may address these issues. Since an employee's household income is likely to be equal to or more than his/her wages, the safe harbor is unlikely to benefit employees by keeping household income the measure of affordability. This is the language in the HCR law itself, however, so its unlikely regulations can change this. The HCR law also clearly states that the affordability calculation *for the employer penalty determination* is based on the cost of "self-only" coverage, not "family" coverage. The IRS said (in the Preamble to recent guidance) that future guidance is expected to base the affordability calculation for purposes of the individual mandate under IRC section 5000A on the employee's required contributions for family coverage under the employer plan. It's not clear whether future guidance will also address the employee's eligibility for a tax credit for Exchange coverage, or only address whether or not a penalty applies if the employee does not purchase coverage for all family members.

Hypothetical Example

The following hypothetical may illustrate these issues. (The actual dollar amounts are used to make the math easy, they are not realistic because they would render the employee eligible for Medicaid rather than for health insurance through the Exchange.)

Assume an employee's annual wages from Employer X are \$10,000 and the employee's household income is \$20,000. Also assume that the employer plan provides coverage that meets the minimum value test.

1. If the annual employee cost for "self-only" coverage is \$950 or less, the employer coverage will be "affordable" and the employer will **not** be subject to a penalty. If the employee buys coverage in the Exchange nonetheless, the employee will **not** be eligible for a tax credit or subsidy.
2. If the annual employee cost for "self-only" coverage is \$951-\$1900, the employee can purchase coverage in the Exchange but will **not** receive a premium tax credit, and the employer will **not** have to pay a \$3,000 annual penalty for that employee.
3. If the annual employee cost for "self-only" coverage is more than \$1900, the employee can purchase coverage in the Exchange and **will** receive a premium tax credit (assuming the other criteria (tax filing status and household income level) are met), and the employer **will** have to pay a \$3,000 annual penalty for that employee.

The issue that still remains for this employee is if the employee has a family and actually needs to cover family members as well. Whether the employee is eligible for the tax credit is still based on whether the employee cost for "self-only" coverage is more than \$1,900.

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