JULY 01, 2024

SSG COMPLIANCE ADVISOR
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STRATEGIC SERVICES GROUP

Using Affordability Safe Harbors to Avoid ACA Penalties

The Affordable Care Act (ACA) requires applicable large employers (ALEs) to offer affordable, minimum-value health coverage to their full-time employees (and dependents) or risk paying a penalty to the IRS. This employer mandate is also known as the "pay-or-play" rules. An ALE is an employer with at least 50 full-time employees, including full-time equivalent employees, during the preceding calendar year.

An ALE's health coverage is considered affordable if the employee's required contribution for the lowest-cost self-only coverage that provides minimum value does not exceed 9.5% (as adjusted) of the employee's household income for the taxable year. For plan years beginning in 2024, the adjusted affordability percentage is 8.39%. The affordability percentage for plan years beginning in 2025 has not been released yet.

Because an employer generally will not know an employee's household income, the IRS has provided three optional safe harbors that ALEs may use to determine affordability based on information that is available to them: the **Form W-2 safe harbor**, the **rate-of-pay safe harbor** and the **federal poverty line (FPL) safe harbor.**

LINKS AND RESOURCES

- IRS final regulations on the ACA's pay-or-play rules
- IRS Revenue Procedure 2023-29, adjusting the affordability percentage for 2024

Affordability Safe Harbors

The IRS has provided three optional safe harbors that ALEs may use to determine their health plan's affordability:

1. **Form W-2 safe harbor;**
2. **Rate-of-pay safe harbor; and**
3. **FPL safe harbor**.

An ALE may choose to use one or more of the safe harbors for all its employees or for any reasonable category of employees, provided it does so on a uniform and consistent basis.

Adjusted Percentage

The affordability contribution percentage is adjusted each year based on the rates of health coverage premium growth relative to the rates of income growth. The adjusted affordability percentage is:

- **8.39%** for plan years beginning in 2024; and
- **9.12%** for plan years beginning in 2023.

Safe Harbor Requirements

The safe harbors allow ALEs to determine if their health plan coverage is affordable based on factors other than employees' household income. ALEs may use the affordability safe harbors if they offer their full-time employees (and dependents) the opportunity to enroll in health plan coverage that provides minimum value. A health plan provides minimum value if it includes substantial coverage of both inpatient hospital services and physician services and covers at least 60% of the total allowed cost of benefits that are expected to be incurred under the plan.

The three affordability safe harbors are all optional. **An ALE may choose to use one or more of the safe harbors for all its employees or for any reasonable category of employees, provided it does so on a uniform and consistent basis for all employees in a category.** Reasonable categories of employees generally include:

- Specified job categories;
- Nature of compensation (for example, salaried or hourly);
- Geographic location; and
- Similar bona fide business criteria.

A listing of employees by name (or other specific criteria having substantially the same effect) is not considered a reasonable category.

The affordability safe harbors are only used to determine whether an ALE's coverage satisfies the affordability test under the pay-or-play rules. They do not affect an employee's eligibility for a premium tax credit for purchasing individual health insurance coverage through an ACA Exchange, which is based on the affordability of employer-sponsored coverage relative to an employee's household income.

Selecting a Safe Harbor

To select a safe harbor for its employees (or for a reasonable category of employees), an ALE should review how each one works. This includes assessing each safe harbor's level of predictability and ability to maximize employee contributions. Certain safe harbors may be more appropriate than others, depending on an ALE's workforce.

The following table provides a quick overview of the three affordability safe harbors and identifies the types of employers who may benefit the most from each.

Safe Harbor	Quick Overview	Pros and Cons
Form W-2	An ALE determines the affordability of its health coverage for each employee by looking at the employee's wages reported in Box 1 of their Form W-2 after the end of the year.	This safe harbor is the least predictable method for determining affordability because it is based on the actual amount of each employee's W-2 wages, which is not known until after the end of the year. Due to this uncertainty, it works best for employees whose annual compensation can be predicted with accuracy before the start of the year. Employees' wages can change during the year for various reasons that are not within the employer's control, such as an increase to pre-tax 401(k) contributions or an unpaid leave of absence. However, if employers are comfortable with this risk, this safe harbor potentially allows them to maximize employee contributions toward the cost of health coverage based on actual compensation.

Safe Harbor	Quick Overview	Pros and Cons
Rate of Pay	An ALE determines the affordability of its health coverage for each employee by looking at the employee's hourly rate multiplied by 130 hours (regardless of the number of hours worked). Monthly salary is used for salaried employees instead of the hourly rate.	This safe harbor provides a more predictable, design-based method for determining affordability. It is especially useful for ALEs with a significant number of hourly employees since it uses an assumed rate of 130 hours per calendar month, regardless of the actual number of hours worked by the employee. However, this safe harbor may not maximize employee contributions toward the cost of health coverage if hourly employees regularly work more than 130 hours per month.
FPL	An ALE determines the affordability of its health coverage for all employees by looking at the FPL for a single individual.	This safe harbor provides the most predictable, design-based method for determining affordability. It gives ALEs a predetermined maximum amount of employee contribution that, in all cases, will result in the coverage being deemed affordable. It is relatively easy to apply because it does not require any employee-specific data. However, it often requires the largest employer contribution toward the cost of health coverage.

Using The Safe Harbors

Form W-2 Safe Harbor

An ALE using the Form W-2 safe harbor **retroactively determines the affordability of its health coverage by looking at each employee's wages reported in Box 1 of Form W-2.** These wages include taxable wages, tips and other compensation paid to the employee for the year, minus any pre-tax benefit deductions.

An ALE's health coverage is considered affordable under the Form W-2 safe harbor for an employee if the employee's required contribution for the ALE's lowest-cost self-only coverage does not exceed 9.5% (as adjusted) of their Form W-2 Box 1 wages for the year. For example, for an ALE's health plan to be considered affordable for the plan year beginning in 2024, the maximum monthly premium for an employee with W-2 wages of $60,000 is $419.50. Here is the formula: $60,000 x 8.39% affordability=$5,034] / 12 months=$419.50 maximum per month.

The following table shows the maximum contribution amounts for selected W-2 wages for plan years beginning in 2024 and 2025.

W-2 Wages	Maximum Monthly Contribution: 2024 Plan Years (8.39% affordability)	Maximum Monthly Contribution: 2025 Plan Years
$30,000	$209.75	To be determined after the IRS releases the affordability percentage for plan years beginning in 2025
$35,000	$244.71	
$40,000	$279.67	
$45,000	$314.63	
$50,000	$349.58	
$55,000	$384.54	
$60,000	$419.50	
$65,000	$454.46	
$70,000	$489.42	
$75,000	$524.38	
$80,000	$559.33	
$85,000	$594.29	
$90,000	$629.25	
$95,000	$664.21	
$100,000	$699.17	
$105,000	$734.13	

To use the Form W-2 safe harbor, the employee's required contribution must remain a consistent amount or percentage of all Form W-2 wages during the plan year. Thus, an ALE may not make discretionary adjustments to the required employee contribution for a pay period. However, a periodic contribution that is based on a consistent percentage of all Form W-2 wages may be subject to a dollar limit specified by the employer.

The Form W-2 safe harbor is adjusted for employees who are not offered coverage for the entire calendar year. The employee's Form W-2 wages are adjusted to reflect the period when the employee was offered coverage, and the adjusted wages are then compared to the employee's share of the premium for the employer's lowest-cost self-only coverage for the periods when coverage was offered.

Rate-of-Pay Safe Harbor

The rate-of-pay safe harbor allows ALEs to prospectively satisfy the ACA's affordability requirement without analyzing every employee's hours. To use the rate of pay safe harbor for hourly employees, an ALE must:

- Take the lower of the hourly employee's rate of pay as of the first day of the coverage period (generally, the first day of the plan year) or the employee's lowest hourly rate of pay during the calendar month;
- Multiply that rate by 130 hours per month (regardless of whether the employee works more or less than 130 hours in a calendar month); and
- Determine affordability for the calendar month based on the resulting monthly wage amount.

An ALE's health coverage is considered affordable under the rate of pay safe harbor for an employee if the employee's required monthly contribution for the lowest-cost self-only coverage does not exceed 9.5% (as adjusted) of the computed monthly wages (that is, the employee's applicable hourly rate of pay multiplied by 130 hours). For example, to meet the affordability threshold for a plan year beginning in 2024, an employee who makes $15 per hour must have a monthly premium of no more than $163.61. Here is the formula: ($15 x 130 hours) x 8.39% affordability=$163.61.

The following table shows the maximum monthly contribution amounts for selected hourly rates of pay for plan years beginning in 2024 and 2025.

Rate of Pay Per Hour	Maximum Monthly Contribution: 2024 Plan Year (8.39% affordability)	Maximum Monthly Contribution: 2025 Plan Year
$10.00	$109.07	To be determined after the IRS releases the affordability percentage for plan years beginning in 2025
$12.50	$136.34	
$15.00	$163.61	
$17.50	$190.87	
$20.00	$218.14	
$22.50	$245.41	
$25.00	$272.68	
$27.50	$299.94	
$30.00	$327.21	
$32.50	$354.48	
$35.00	$381.75	

An ALE may use the rate-of-pay safe harbor even if an hourly employee's rate of pay is reduced during the year. In this situation, the rate of pay is applied separately to each calendar month rather than to 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. Also, the affordability calculation under the rate of pay safe harbor is not altered by a leave of absence or reduction in hours worked.

For salaried employees, monthly salary as of the first day of the coverage period would be used instead of hourly salary multiplied by 130 hours. For example, for a plan year beginning in 2024, if a salaried employee makes $4,000 per month, the maximum monthly premium must be no more than $335.60 ($4,000 x 8.39%=$335.60). However, if the monthly salary is reduced, including due to a reduction in work hours, the rate-of-pay safe harbor may not be used.

FPL Safe Harbor

The FPL safe harbor allows ALEs **to prospectively satisfy the ACA's affordability requirement without analyzing employees' wages or hours.** The FPL safe harbor provides ALEs with a predetermined maximum amount of employee contribution that, in all cases, will result in the ALE's health coverage being deemed affordable.

An ALE's health coverage is considered affordable under the FPL safe harbor for all employees if the employee monthly contribution amount for the lowest-cost self-only coverage does not exceed 9.5% (as adjusted) of the FPL for a single individual for the applicable year, divided by 12. ALEs may use any FPL guidelines that are in effect **within six months before the first day of the plan year.** This provides employers with time to establish premium amounts in advance of the plan's open enrollment period. However, because the federal government does not typically release the updated FPL for the year until January, employers with calendar-year health plans generally use the prior year's FPL.

To calculate affordability under this safe harbor, take the 2023 FPL for an individual ($14,580), multiply it by 8.39% and then divide it by 12. This formula is as follows: ($14,580 x 8.39% affordability)/12=$101.94. In general, if employee contributions for the lowest-cost self-only coverage do not exceed $101.94 per month, the health coverage meets the ACA's affordability standard for all employees.

The following table shows the FPL affordability thresholds using the FPL guidelines for 2023 and 2024.

State of Employment	2023 FPL Guidelines		2024 FPL Guidelines	
	FPL for a single individual	Maximum monthly contribution for 2024 plan years (using 8.39% affordability)	FPL for a single individual	Maximum monthly contribution for 2024 plan years (using 8.39% affordability)
48 contiguous states and the District of Columbia	$14,580	$101.94	$15,060	$105.29
Alaska	$18,210	$127.32	$18,810	$131.51
Hawaii	$16,770	$117.25	$17,310	$121.03

Calendar-year health plans will apply the 2024 FPL guidelines to determine affordability for the plan year beginning on Jan. 1, 2025. They will also need to use the inflation-adjusted affordability percentage for plan years beginning in 2025, which has not yet been released by the IRS.