

ACA: EMPLOYER MANDATE PENALTIES AND AFFORDABILITY

All applicable large employers are at risk for employer mandate penalties, including for-profit, nonprofit, private employers, churches, government entities and Indian tribal government employers.

The ACA requires applicable large employers – those with 50 or more full-time employees (FTEs) and full-time equivalents – to offer affordable minimum value coverage to substantially all FTEs (those working 30 hours or more per week) and their dependents, or risk a penalty. The requirement, known as the employer mandate or employer shared responsibility provision, has been in effect since 2015.

The employer mandate consists of two potential penalties: Penalty A (for failure to offer coverage to the required percentage of full-time employees) and Penalty B (for failure to offer coverage that is of minimum value and affordable). Although an employer's fact pattern may show that both failures exist simultaneously, Penalty B is triggered only if Penalty A does not also apply to the same reporting month. Special rules – described in further detail below – apply to employers that are part of a controlled group (i.e., share common ownership or control). In addition, although generally expressed as an annual amount, both penalties are calculated and assessed on a monthly basis. See Appendix A, **Employer Mandate**, for details of the penalty amounts and affordability threshold.

For more detailed information about identifying and counting full-time employees and full-time equivalent employees, see the PPI publications **ACA: Employer Mandate Full-Time Employees** and **ACA: Applicable Large Employers**. For further discussion of how specific employee cost-share contribution models affect the ACA affordability safe harbor calculations, see the PPI publication **Cost-Share Contribution Models: A Guide for Employers**.

PENALTY A

Penalty A, generally viewed as the more severe penalty, is triggered if the employer fails to offer minimum essential coverage (MEC) to substantially all FTEs and their dependents, and at least one FTE receives a premium tax credit or cost-sharing reduction through a state health insurance exchange. It is assessed on the total number of FTEs (minus the first 30) in each month for which the triggering failure occurs. If an employer is offering MEC to substantially all FTEs and their dependent children for each month of the year, then the employer will not be subject to Penalty A. To avoid Penalty A, employers must understand the meanings of "MEC," "substantially all" and "dependent."

Minimum Essential Coverage

"MEC" is defined very broadly as an "eligible employer-sponsored plan," which includes fully insured group coverage offered in the small or large market, as well as many self-insured plans. Importantly, though, MEC does not include HIPAA-exceptions benefits, such as health FSAs, disability coverage, accidental death and dismemberment coverage, and limited-purpose or stand-alone dental or vision coverage.

Substantially All

"Substantially all" generally means 95% of all FTEs (or five FTEs, if greater than 95%). That is, an employer must offer MEC to no fewer than 95% of its FTEs (or five FTEs, if greater).



Dependent

“Dependent” means a child of an employee who has not attained age 26. This includes biological and adopted children, but does not include step or foster children or the children of an employee’s domestic partner. Dependent status applies for the entire calendar month in which the child attains age 26. Importantly, the term does not include a spouse (whether same- or different-sex) or a domestic partner. Thus, employers need not offer coverage to employees’ spouses or domestic partners to avoid liability for the employer mandate penalty. However, for fully insured plans, state law may prohibit employers from excluding spouses or domestic partners from coverage. For further information about state law requirements to offer domestic partner health coverage, see the PPI publication [Domestic Partner Benefits: A Guide for Employers](#).

PENALTY B

Penalty B is triggered if an employer offers MEC to substantially all FTEs and their dependents, but the coverage is either not of minimum value (MV) or is not affordable. It is assessed only on the sub-set of employees who receive a premium tax credit or cost-sharing reduction in any one or more months. To avoid Penalty B, employers must understand the meanings of “MV” and “affordable.”

Minimum Value

“MV” means that the plan will pay at least 60% of the costs incurred by the participant and their beneficiaries. In other words, the employee cannot be responsible for more than 40% of the total benefit costs that they incurred under the plan. Importantly, employer contributions to a health savings account (HSA) and an integrated health reimbursement arrangement (HRA) (so long as HRA reimbursements are not limited only to premiums) are included in the plan’s share of costs for purposes of the MV calculation. Overall, there are several methods to determine minimum value.

MV Calculator: This tool is available through the US Department of Health and Human Services (HHS) website; it allows employers to enter details of the plan and calculate MV. The MV calculator is similar to the actuarial value (AV) calculator developed by HHS to determine the AV of qualified health plans offered through the state health insurance exchanges, although the AV calculator cannot be used to determine MV.

Design-Based MV Safe Harbor Checklist: This tool provides several examples of plan designs that would satisfy the 60% threshold if measured using the MV calculator. Proposed plan designs for the checklist include plans with a:

1. \$3,500 integrated medical/drug deductible, 80% plan cost-sharing and a \$6,000 out-of-pocket (OOP) maximum limit for employee cost-sharing
2. \$4,500 integrated medical/drug deductible, 70% plan cost-sharing, \$6,400 OOP maximum limit and a \$500 employer contribution to an HSA
3. \$3,500 medical deductible, \$0 drug deductible, 60% plan medical cost-sharing, 75% drug cost-sharing, a \$6,400 OOP maximum limit and drug copays of \$10/\$20/\$50 for first, second and third prescription drug tiers, with 75% coinsurance for specialty drugs

The IRS has indicated that future guidance will further expand the safe harbor plan design list and will hopefully include additional common plan design features, such as copayments for office visits or other services.

Actuarial Certification: Employers can also seek certification by an actuary to determine MV. Certification is particularly recommended where the plan has nonstandard features, such as limits on the number of physician visits or covered days in a hospital.

Affordable

“Affordable” means that an employee’s premium cost-share for the lowest-cost self-only coverage does not exceed a denominated percentage (as adjusted annually by the IRS) of that employee’s household income. See Appendix A, **Employer Mandate**, for details of the affordability threshold. Note that a new IRS rule effective 1/1/2023 establishes a separate affordability threshold for the cost of family coverage as distinct from self-only coverage. Importantly, the new rule does not impact the employee affordability test and does not increase an employer’s exposure to employer mandate penalties; however, it may prompt more families to drop employer-sponsored coverage in favor of newly subsidized ACA marketplace coverage.

Because employers generally will not know an employee’s total household income, there are three available safe harbors for determining whether coverage is affordable. See Appendix B, **Sample ACA Affordability Safe Harbor Calculations**, for illustrations of each of the following three affordability safe harbors.

Federal Poverty Line (FPL) Safe Harbor: Under the FPL safe harbor, coverage is affordable if the lowest-cost self-only coverage does not exceed the indexed affordability threshold factor relative to the FPL for a single individual divided by 12 (to convert the FPL from an annual to a monthly amount). By using the FPL safe harbor, employers may ignore employees' actual wages (thus avoiding troublesome issues such as fluctuation in hours, increase or decrease in rates of pay, etc.). Importantly, to allow time for planning, employers may use the FPL guidelines in effect six months prior to the beginning of the plan year.

Rate of Pay Safe Harbor: Under the rate of pay safe harbor, coverage is affordable if the lowest-cost self-only coverage does not exceed the indexed affordability threshold factor relative to an employee's rate of pay. For an hourly employee, the employer uses an assumed rate of 130 hours per calendar month multiplied by the hourly employee's rate of pay (regardless of whether the employee actually works more or less than 130 hours). For a non-hourly (salaried) employee, the employer uses the employee's monthly salary as of the first day of the coverage period.

Special rate of pay safe harbor rules apply when an employee's rate of pay increases or decreases during a month or year. Employers should contact their benefits consultant for help in those situations.

Form W-2 Safe Harbor: Under the Form W-2 safe harbor, coverage is affordable if an employee's lowest-cost for self-only coverage does not exceed the indexed affordability threshold factor relative to that employee's Form W-2 wages (as reported in Box 1). So, on an employee-by-employee basis, the employer compares the employee's current, expected Form W-2 wages to the amount of the employee's required premium contribution for the current calendar year.

While the actual application of the Form W-2 safe harbor would generally be performed retroactively at the end of the calendar year, employers can use the safe harbor prospectively at the beginning of the calendar year by setting the employee contribution for self-only coverage at a level that does not exceed the indexed affordability threshold factor relative to the lowest-paid employee's projected Form W-2 wages. Setting the safe harbor contributions prior to having actual Form W-2 data available can make this approach tricky to implement, particularly where Form W-2 wages fluctuate dramatically during the year. But it is a good option for employers with stable compensation costs.

In summary, employers may (but are not required to) rely on any one of the three safe harbors to determine whether coverage is affordable. Employers may also use different safe harbors for different classes of employees, so long as the classes are based on a business purpose (such as specified job classifications, hourly vs. salaried employees, geographic location or any other legitimate business criteria). Also, generally speaking, employer HSA contributions and wellness program premium discounts or surcharges (except if tobacco-related) are not included in determining affordability. Contributions to integrated HRAs may only be included in determining affordability if HRA funds can be used to pay premiums (in that case, the HRA contributions could not also count toward satisfying MV, described above).

APPLICATION OF PENALTIES TO CONTROLLED GROUPS

The employer mandate incorporates the controlled group rules found in Internal Revenue Code Section 414. Under Section 414, if two or more companies have sufficient common ownership or are under common control, they are treated as a single employer. A discussion of Section 414 is beyond the scope of this paper, but the most basic controlled group would be where a parent company owns 80% or more of one or more subsidiaries (known as a parent-subsidiary controlled group).

As it relates to the employer mandate penalties, the coverage tests and penalty assessments for controlled groups are calculated and imposed separately on each company within the controlled group (referred to as "controlled group members"). In other words, the penalties apply on a member-by-member basis, such that the parent company is not liable for the subsidiary company's failure to offer affordable coverage to subsidiary employees (and vice versa). Accordingly, each controlled group member is responsible for ensuring that it offers affordable, MV coverage to substantially all of its FTEs and their dependents, or it risks paying a penalty for its own failure.

Along those lines, if an FTE is working for multiple controlled group members, the member for whom the FTE has the greatest number of hours of service is the member with employer mandate responsibility. However, an offer of coverage by one controlled group member is treated as an offer of coverage by all controlled group members for that month.

Lastly, with respect to the 30-employee reductions in calculating Penalty A, the reduction is allocated ratably among controlled group members based on the number of FTEs employed by each member (and the ratable share can be rounded up one FTE).

PAYMENT AND TAX TREATMENT OF PENALTIES

Employers and controlled group members are responsible for reporting and paying employer mandate penalties in the year following the compliance year. (A full discussion of reporting is beyond the scope of this paper. For additional information on

reporting and assessing penalties, see the PPI publications [ACA: Employer Mandate Reporting Requirements](#) and [ACA: FAQs on IRS Letter 226-J](#).) Finally, employers should note that employer mandate penalty payments are not tax deductible.

SUMMARY

The ACA employer mandate requires employers that meet the definition of an ALE to offer affordable coverage to their employees or pay a tax penalty for their failure to do so.

RESOURCES

[Final Rule 2014](#)

[Final Rule 2022](#)

[IRS FAQ](#)

About PPI

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APPENDIX A

Employer Mandate

	2023	2022	2021
Penalty A, annual (per FT EE*)	TBD	\$2,750	\$2,700
Penalty B, annual (per EE receiving premium tax credit)	TBD	\$4,120	\$4,060
Affordability threshold	9.12%	9.61%	9.83%

*Minus the first 30 FT employees.

The chart above is excerpted from the PPI publication [Employee Benefits Annual Limits](#). See that publication for other annual limits that affect group health plans.

APPENDIX B

Sample Affordability Safe Harbor Calculations

Federal Poverty Line (FPL) Safe Harbor

	2023 (July-Dec)	2023 (Jan-June)	2022 (July-Dec)	2022 (Jan-June)	2021
Affordability threshold*	9.12%	9.12%	9.61%	9.61%	9.83%
Federal poverty line**	TBD	\$13,590	\$13,590	\$12,880	\$12,880
Maximum self-only cost-share (per month)***	TBD	\$103.28	\$108.83	\$103.14	\$105.50

*Affordability threshold pertains to plan years beginning in the referenced calendar year.

**FPL safe harbor uses federal poverty line for one person household. Annual FPL figures shown are for the 48 contiguous states and the District of Columbia; figures for Alaska and Hawaii are higher.

***The calculation formula for the FPL safe harbor "Maximum self-only cost-share (per month)" is as follows: (Affordability Threshold x Federal Poverty Line) / 12. For plan years beginning between January and June of a calendar year, plan sponsors can rely on the prior calendar year federal poverty line for the FPL safe harbor calculation. While there appears to be no formal guidance regarding the rounding rules for ACA affordability calculations, the dollar figures in this chart have, in an abundance of caution, been uniformly rounded down to the nearest penny.

Rate of Pay Safe Harbor

		Maximum Self-Only Cost-Share (per month)		
		2023	2022	2021
Affordability threshold*		9.12%	9.61%	9.83%
	Sample Hourly Rate of Pay**			
	\$7.25	\$85.95	\$90.57	\$92.64
	\$10.00	\$118.56	\$124.93	\$127.79
	\$15.00	\$177.84	\$187.39	\$191.68
	\$20.00	\$237.12	\$249.86	\$255.58
	\$25.00	\$296.40	\$312.32	\$319.47
	\$30.00	\$355.68	\$374.79	\$383.37
	Sample Monthly Salary***			
	\$2,083	\$189.96	\$200.17	\$204.75
	\$2,500	\$228.00	\$240.25	\$245.75
	\$2,917	\$266.03	\$280.32	\$286.74
	\$3,333	\$303.96	\$320.30	\$327.63
	\$3,750	\$342.00	\$360.37	\$368.62
	\$4,167	\$380.03	\$400.44	\$409.61

*Affordability threshold pertains to plan years beginning in the referenced calendar year.

**The calculation formula for the Rate of Pay safe harbor "Maximum self-only cost-share (per month)" for Hourly employees is as follows: (Affordability Threshold x Hourly Rate of Pay x 130). While there appears to be no formal guidance regarding the rounding rules for ACA affordability calculations, the dollar figures in this chart have, in an abundance of caution, been uniformly rounded down to the nearest penny.

***The calculation formula for the Rate of Pay safe harbor "Maximum self-only cost-share (per month)" for Salaried employees is as follows: (Affordability Threshold x Monthly Salary). See previous note regarding penny rounding practice.

Form W-2 Safe Harbor

		Maximum Self-Only Cost-Share (per month)		
		2023	2022	2021
Affordability threshold*		9.12%	9.61%	9.83%
	Sample Annual Earnings (Form W-2, Box 1)**			
	\$25,000	\$190.00	\$200.20	\$204.79
	\$30,000	\$228.00	\$240.25	\$245.75
	\$35,000	\$266.00	\$280.29	\$286.70
	\$40,000	\$304.00	\$320.33	\$327.66
	\$45,000	\$342.00	\$360.37	\$368.62
	\$50,000	\$380.00	\$400.41	\$409.58

*Affordability threshold pertains to plan years beginning in the referenced calendar year.

**The calculation formula for the Form W-2 safe harbor "Maximum self-only cost-share (per month)" is as follows: (Form W-2 Box 1 Earnings x Affordability Threshold) / 12. While there appears to be no formal guidance regarding the rounding rules for ACA affordability calculations, the dollar figures in this chart have, in an abundance of caution, been uniformly rounded down to the nearest penny.