New Guidance Addresses Affordability and the Employer Penalty

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As background, applicable large employers ("ALEs") may be subject to the Employer Penalty if any full-time employee ("FTE") receives a subsidy to purchase Exchange coverage. There are two penalties, "A" and "B." The "B" Penalty can apply when the ALE offers at least 95% of FTEs and their dependent children minimum essential coverage ("MEC") but the coverage is not **affordable**, does not provide minimum value, or excludes 5% or fewer FTEs.

IRS Notice 2015-87 provides further guidance on the affordability component (and other topics to be summarized in future articles).

Unless otherwise provided, the guidance in Notice 2015-87 applies for plan years beginning on or after January 1, 2016, but employers may rely upon this guidance for all prior periods.

The concept of affordability is significant as it affects:

- whether an employer is subject to a "B" Penalty assessment; and
- how an employer reports the affordability of any group health plan coverage offered to full-time employees on Form 1095-C (Line 15) and the affordability safe harbor used for those who waive coverage (Line 16).

Inflation Adjustments To 9.5%

Background. The IRS provides three safe harbors the employer may use to establish affordable coverage in order to avoid the "B" Penalty. Under the safe harbors, an employer's offer of coverage is affordable with respect to an employee if the required contribution for self-only coverage in the lowest cost health plan that provides minimum value does not exceed 9.5% of:

- Form W-2 Safe Harbor. The employee's Form W–2 wages as determined at the end of the year.
- Rate of Pay Safe Harbor. the employee's rate of pay determined by multiplying 130 hours by the hourly rate of pay for an hourly employee, or by using monthly salary for non-hourly employees.
- FPL Safe Harbor. The monthly income for a single individual at 100% of the Federal Poverty Line ($93.18 per month for 2015).

New Guidance. In each of the safe harbors, the reference to 9.5% will be adjusted annually, consistent with the determination of affordable coverage for purposes of an individual's eligibility for subsidies. The rates for the first two years are as follows:

Calendar Year	Percentage (with adjustment)
2015	9.56%
2016	9.66%

Employers may rely upon the adjusted amounts for plan years beginning in 2015. Thus, the FPL safe harbor for 2015 is no more than $93.77 per month (slightly more than the unadjusted 2015 amount). The FPL for 2016 has not yet been issued.

These adjustments also apply with respect to the multiemployer plan interim relief, the requirement that employees be permitted to decline enrollment in coverage with a limited exception to affordable/minimum value coverage as determined under the FPL safe harbor, the definition of a Qualifying Offer for purposes of reporting on Line 14 of Form 1095-C (Code 1A), and use of alternative reporting methods for Qualifying Offers.

Flex Contributions and Affordability (Q/A-8)

Background. In some cases, employers provide flex contributions under a cafeteria plan. Employees can use these contributions toward the purchase of benefits.

New Guidance. Flex contributions reduce the amount of an employee's required contribution only if:

- the employee may not opt to receive the amount as a taxable benefit;
- the employee may use the amount to pay for MEC; and
- the employee may use the amount exclusively to pay for medical care (as defined under Code section 213).

This is referred to as a "health flex contribution."

Transition Relief

For plan years beginning before January 1, 2017, a flex contribution that is not a health flex contribution (Examples 2 and 3 above) will be treated as reducing the amount of an employee's required contribution (affordability determined based on $150 as opposed to $200) provided:

- the employer offered the flex contribution arrangement (or a substantially similar flex contribution arrangement) for a plan year including December 16, 2015;
- a board, committee, or similar body or an authorized officer of the employer specifically adopted the flex contribution arrangement before December 16, 2015; or

Example 1

Employer offers employees coverage under a group health plan through a cafeteria plan. An employee electing self-only coverage under the health plan is required to contribute $200 per month toward the cost of coverage. Employer offers employer flex contributions of $600 for the plan year ($50 per month) that may only be applied toward the employee's share of contributions for the group health coverage or contributed to a health FSA.

The $600 employer flex contribution is a health flex contribution and reduces the employee's required contribution for the coverage. This affects the affordability determination for purposes of the employer mandate and applicable reporting. The $600 employer health flex contribution is taken into account as an employer contribution (and therefore reduces the employee's required contribution) regardless of whether the employee elects to apply the health flex contribution toward the employee contribution for the group health coverage or elects to contribute it to the health FSA.

The employee's required contribution for the group health coverage is $150 ($200 - $50) per month. Affordability is determined using $150 per month.

Example 2

Same facts as Example 1, but the employer flex contributions can be used for any benefit under the cafeteria plan (including benefits not related to health) but are not available as cash.

Because the $600 employer flex contribution is not used exclusively for medical care, it is not a health flex contribution and therefore does not reduce the employee's required contribution for the coverage. The employee's required contribution for the group health coverage is $200 per month. Affordability is determined using $200 per month.

The employee's required contribution for the group health coverage is $150 ($200 - $50) per month. Affordability is determined using $150 per month.

Example 3

Same facts as example 2, but instead the flex contribution is available to pay for health benefits or to be taken as cash or other taxable compensation (and not available to pay for other types of benefits).

Same result as Example 2.

- the employer provided written communications to employees on or before December 16, 2015 indicating that the flex contribution arrangement would be offered to employees at some time in the future.

1095-C Reporting

While employers eligible for the limited relief described above may reduce the amount of the employee's required contribution for purposes of Form 1095-C reporting (Line 15) by the amount of a non-health flex contribution, they are not encouraged to do so, as it may affect the employee's eligibility for the premium tax credit.

If an employee's required contribution is reported in this manner (that is, without reduction for the amount of a non-health flex contribution) and the employer is contacted by the IRS concerning a potential "B" Penalty assessment relating to the employee's receipt of a premium tax credit, the employer will have an opportunity to respond and show that it is entitled to the relief contain in this Notice to the extent that the employee would not have been eligible for the premium tax credit if the required employee contribution had been reduced by the amount of the non-health flex contribution or to the extent that the employer would have qualified for an affordability safe harbor if the required employee contribution had been reduced by the amount of the non-health flex contribution.

Opt-Out Bonuses and Affordability (Q/A-9)

Background. Under a cafeteria plan, an employer may offer an employee a "cash option," a taxable amount that is available if the employee declines coverage under the employer's health plan (also referred to as an "opt-out bonus").

New Guidance. Treasury and IRS intend to issue regulations that treat an unconditional opt-out arrangement (that is, an arrangement providing for a payment conditioned solely on an employee declining coverage under an employer's health plan) in the same manner as a salary reduction for purposes of determining an employee's required contribution.

It is anticipated that proposed regulations will also address and request comments on the treatment of opt-out bonuses that are conditioned not only on the employee declining employer-sponsored coverage but also on satisfaction of additional conditions (such as the employee providing proof of having coverage provided by a spouse's employer or other coverage).

Example

An employer offers employees group health coverage through a cafeteria plan, requiring employees who elect self-only coverage to contribute $200 per month toward the cost of that coverage and offers an additional $100 per month in taxable wages to each employee who declines the coverage.

For purposes of affordability, the employee cost would be $300. This is because the offer of $100 in additional compensation has the economic effect of increasing the employee's contribution for the coverage. In this case, the employee contribution for the group health plan effectively would be $300 ($200 + $100) per month, because an employee electing coverage under the health plan must forgo $100 per month in compensation in addition to the $200 per month in salary reduction.

Effective Date/"B" Penalty/1095-C Reporting

Any required inclusion will generally apply only for periods after the issuance of final regulations, except in the case of a non-relief-eligible opt-out arrangement. This means an opt-out bonus (other than a payment made under a non-relief-eligible opt-out arrangement):

- will not be treated as increasing an employee's required contribution for purposes of a "B" Penalty assessment; and
- employers are not required to increase the amount of an employee's required contribution by the amount of an opt-out bonus for purposes of Form 1095-C reporting (Line 15).

An arrangement will be considered a non-relief-eligible opt-out arrangement requiring the inclusion of an amount offered or provided under an unconditional opt-out arrangement, unless:

1. the employer offered the opt-out arrangement (or a substantially similar opt-out arrangement) with respect to health coverage provided for a plan year including December 16, 2015;

2. a board, committee, or similar body or an authorized officer of the employer specifically adopted the opt-out arrangement before December 16, 2015; or
3. the employer had provided written communications to employees on or before December 16, 2015 indicating that the opt-out arrangement would be offered to employees at some time in the future.

Service Contract Act ("SCA") and Davis Bacon Act and Davis Bacon Related Acts ("DBRA") Fringe Benefits and Affordability (Q/A-10)

Background. The SCA and DBRA require that workers employed on certain federal contracts be paid prevailing wages and fringe benefits. Under the SCA and DBRA, an employer generally can satisfy its fringe benefit obligations by:

- providing a particular benefit or benefits, as determined by the employer, that have a sufficient dollar value; or
- providing the cash equivalent of benefits or some combination of cash and benefits; or
- allowing employees to choose among various benefits or among various benefits and cash.

If an employer chooses to provide fringe benefits under the SCA or DBRA by offering an employee the option to enroll in health coverage provided by the employer (including an option to decline that coverage) and the employee declines the coverage, that employer then generally is required to provide the employee with cash or other benefits of an equivalent value. An employer that chooses to satisfy its obligation to provide fringe benefits under the SCA or DBRA by offering an employee the option to enroll in health coverage provided by the employer (including an option to decline that coverage) generally would need to provide a significant additional subsidy to make the offer affordable. While the SCA and DBRA require employers to pay covered employees no less than prevailing wage and fringe benefit rates, this additional subsidy would result in certain employees receiving amounts significantly in excess of SCA and DBRA minimum rates.

New Guidance. Until the applicability date of any further guidance, and in any event for plan years beginning before January 1, 2017, employer fringe benefit payments (including flex credits or flex contributions) under the SCA or DBRA that are available to employees covered by the SCA or DBRA to pay for coverage under an eligible employer-sponsored plan (even if alternatively available to the employee in other benefits or cash) will be treated as reducing the employee's required contribution for participation in that eligible employer-sponsored plan for purposes of affordability, but only to the extent the amount of the payment does not exceed the amount required to satisfy the requirement to provide fringe benefit payments under the SCA or DBRA

Example

Employer offers employees subject to the SCA or DBRA coverage under a group health plan through a cafeteria plan, which the employees may choose to accept or reject. Under the terms of the offer, an employee may elect to receive self-only coverage under the plan at no cost, or may alternatively decline coverage under the health plan and receive a taxable payment of $700 per month. For the employee, $700 per month does not exceed the amount required to satisfy the fringe benefit requirements under the SCA or DBRA.

Until the applicability date of any further guidance (and in any event for plan years beginning before January 1, 2017), the required employee contribution for the group health plan for an employee who is subject to the SCA or DBRA is $0 for purposes of the "B" Penalty and reporting on Form 1095-C.

1095-C Reporting

Employers are encouraged to treat these fringe benefit payments as not reducing the employee's required contribution for purposes of reporting on Form 1095-C (thus reflect $700 as opposed to $0 on the Form 1095-C, Line 15).

If an employee's required contribution is reported without reduction for the amount of the fringe benefit payment and the employer is contacted by the IRS concerning a potential "B" Penalty, the employer will have an opportunity to respond and show that it is entitled to the relief contained in the Notice to the extent that the employee would not have been eligible for the premium tax credit if the required employee contribution had been reduced by the amount of the fringe benefit payment or to the extent that the employer would have qualified for an affordability safe harbor if the required employee contribution had been reduced by the amount of the fringe benefit payment.

Treasury and IRS continue to consider other methods for reporting the amount of the required contribution for employees subject to the SCA or DBRA, including the possible use of indicator codes. However, any new methods will not require implementation for reporting on plan years beginning before January 1, 2017.

Implications For Some Employees (Q/A-11)

Certain individuals may be affected by Q/A-8 through 10 because employers are permitted to report a lower amount as the employee's required contribution on the Form 1095-C. Specifically, employees who (1) enrolled in coverage through the Marketplace, (2) did not receive the benefit of advance payments of the premium tax credit, and (3) have household income is in the range for premium tax credit eligibility (100% - 400% FPL), may need additional information from their employers regarding their required employee contribution to determine eligibility for the premium tax credit.

Employers that use the available relief are encouraged to notify employees that they may obtain accurate information about their required contribution taking into account the modifications provided to the employer through the Notice using the employer contact telephone number provided to the employee on Form 1095-C. If the modified required contribution is not affordable and the employee is otherwise entitled to the premium tax credit, the employee may claim it on Form 8692, Premium Tax Credit, which is filed with the employee's annual income tax return (regardless of the required contribution or qualifying offer information reported on that employee's Form 1095-C).