September 29, 2022

A Double Whammy for 2023

The 2023 Affordability Safe Harbor Percentage and the Extension to the Enhanced Public Health Insurance Marketplace Subsidies

Two events occurred in 2022 that will affect employer efforts to avoid Affordable Care Act (ACA) employer mandate penalties in 2023.[1]

First, the IRS released Revenue Procedure 2022-34, which set the 2023 affordability safe harbor percentage for employer-provided medical coverage to 9.12%. This is an annually indexed amount and a sharp decrease from 2022's 9.61% safe harbor percentage.[2] In fact, the decrease to 9.12% is the largest single year change and lowest annual affordability percentage to date. This affordability percentage affects both: (1) individuals' eligibility for subsidies in the public health insurance marketplace (the "Marketplace"), and (2) the employer affordability safe harbors used to avoid potential employer mandate penalties.

Second, the Inflation Reduction Act of 2022 (IRA) extended the enhanced Marketplace subsidies originally enacted under the American Rescue Plan Act of 2021. The enhanced subsidies now run through 2025 and increase the likelihood that employees will seek and be eligible for subsidized Marketplace coverage.

This Alert provides: (i) A summary of the ACA's employer mandate penalties; (ii) the employer affordability safe harbors and the effect of the 9.12% affordability safe harbor percentage when setting employee contributions for 2023 plan years; and (iii) the potential effect of the extension to the enhanced Marketplace subsidies.

A Summary of the ACA's Employer Mandate Penalties

The ACA's employer mandate penalties are indexed annually and only apply to applicable large employers (ALEs) that fail to meet certain minimum standards for offering medical coverage to full-time (FT) employees. A discussion of how to determine ALE and FT employee status is beyond the scope of this Alert.

IRC §4980H(a) "no offer" penalty

This penalty applies when an ALE fails to offer minimum essential coverage (MEC) to at least 95% of its FT employees for a calendar month and at least one FT employee obtains subsidized coverage in the Marketplace for that month. Most employer-provided medical coverage qualifies as MEC. For the purposes of avoiding this penalty, it does not matter if the offer of coverage is affordable or if the coverage satisfies the ACA's minimum value requirements.[3]

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[1] The ACA's employer mandate penalties are also known as the employer shared responsibility penalties and the pay or play penalties.

[2] The current methodology measures premium growth against income growth. A percentage decrease indicates the gap in growth rates narrowed.

[3] In general, minimum value means the plan pays at least 60 percent of the expected total allowed cost of benefits for the plan year.

The 2023 §4980H(a) annual penalty amount is $2,880 ($240/month).[4] The penalty calculation multiplies this amount by all of the ALE's FT employees for the given month minus the 30 FT employee exclusion amount.[5]

Example

An ALE fails to offer MEC to at least 95% of its 127 FT employees in April 2023, and at least 1 FT employee qualifies for a Marketplace subsidy that month.

$240 × (127 - 30) = $23,280 for April 2023

IRC §4980H(b) "inadequate offer" penalty

This penalty applies when an ALE offers MEC to at least 95% of its FT employees, but it fails to offer affordable, minimum value coverage to one or more FT employees who qualify for a subsidy in the Marketplace. This penalty determines affordability solely on the employee contribution toward employee-only coverage in the employer's lowest cost medical plan offered to the FT employee that provides minimum value, regardless of what coverage option is elected, or whether coverage is waived.

The 2023 §4980H(b) annual penalty amount is $4,320 ($360/month).[6] Unlike the §4980H(a) penalty, this penalty only applies to the FT employee/s that trigger the penalty that month.

Example

An ALE offers MEC to 100% of its FT employees for the entire 2023 calendar year, but the offer of coverage does not meet the employer's chosen affordability safe harbor for some of them. Assume that 5 FT employees offered unaffordable coverage qualify for Marketplace subsidies in April 2023.

$360 × 5 = $1,800 for April 2023

Did you know? An ALE does not get credit for offering coverage to a FT employee unless the employee can also enroll his or her natural and adopted children up to age 26, if any.

The Employer Affordability Safe Harbors

Brief background

The trigger for potential employer mandate penalties is whether a FT employee obtains a Marketplace subsidy during a given month. An individual who enrolls in medical coverage, or who waives affordable employer medical coverage that meets the ACA's minimum value requirements, is generally ineligible for a Marketplace subsidy. The subsidy affordability calculation measures the offer of coverage against the individual's household income. At a high

[4] See Questions and Answers on Employer Shared Responsibility Provisions Under the Affordable Care Act, Q/A #55.

[5] The 30 FT employee exclusion amount applies as a single combined limit for related legal entities that must count together when determining ALE status (known as an aggregated ALE group). A group member's proportion of the group's total FT employees determines its share of the exclusion amount. For example, if a member has 50% of the aggregated ALE group's FT employees, it can exclude 15 FT employees from its own penalty calculation (50% × 30 = 15).

[6] See Questions and Answers on Employer Shared Responsibility Provisions Under the Affordable Care Act, Q/A #55.

level, household income is adjusted gross income from all sources[7] reported on the taxpayer's federal personal income tax return after certain adjustments.

The ACA provides employers with three safe harbors (one has two subparts) that qualify as affordable offers of coverage by an employer for the purposes of avoiding the employer mandate penalties. These safe harbors do not require an employer to have any knowledge of an employee's household income. The three safe harbors are:

1. Federal poverty line;
2. Form W-2; and
3. Rate of Pay.

While uncommon, the use of household income for Marketplace subsidy eligibility purposes makes it possible for an individual to qualify for a Marketplace subsidy even though their employer offered coverage that met an affordability safe harbor. The safe harbor still prevents an FT employee from triggering an employer mandate penalty in this situation.

The 2023 affordability safe harbor percentage and other general employer affordability safe harbor notes

The most recent affordability safe harbor percentages used to determine Marketplace subsidy eligibility and the employer affordability safe harbors are below.

Calendar Year	Affordability Percentage
2021	9.83%
2022	9.61%
2023	9.12%

The following notes apply broadly to employer affordability safe harbors:

- Safe harbor calculations – An affordability calculation uses the employee cost for the lowest cost employee-only, minimum value plan the employee could have elected. It makes no difference if the employee waives coverage, enrolls a spouse and/or dependents, or enrolls in a more expensive plan option.

> **Wellness Programs:** If wellness incentives affect the employee contribution toward medical coverage, the employer must treat all employees as tobacco-free and failing all other incentives when performing employer affordability calculations. It does not matter what wellness standards an employee actually satisfies.

- Plan year – Affordability calculations use the affordability percentage in effect at the beginning of the plan year. For example, a plan with a July 1, 2022 – June 30, 2023 plan year will use 9.61% for the entire plan year for affordability calculation purposes.
- Classes of employees – The regulations allow an employer to define and apply different safe harbors to different classes of employees. The regulations indicate the categories must be reasonable, and the same safe harbor must apply to all employees within a class. Reasonable classifications include the following:

[7] This includes a spouse's income if the spouses file a joint tax return as well as investment, rental, and/or other business income. Please note that various losses and/or other deductions can lower household income below the taxable compensation amounts reported by employers.

- Hourly and salaried employees;
- Union (i.e. collectively bargained) and non-union employees;
- Employees working in different geographic locations; and
- Employees in different job categories (e.g. corporate and retail).

Federal poverty line (FPL) safe harbor

Under the FPL safe harbor, coverage is affordable for plan years beginning in 2023 if the employee's share of the premium does not exceed 9.12% of the individual FPL amount for the calendar year divided by 12. The U.S. Department of Health & Human Services (HHS) publishes the FPL amounts annually. There is one set of FPL amounts for the continental United States. Separate and higher FPL amounts apply to Alaska and Hawaii.

Since the FPL amounts are usually not available from HHS for a given year before late January or early February of that year, calendar plan years technically use the prior year individual FPL amount, and the rules allows plans to use the individual FPL amount in effect six months prior to the start of the plan year.

An employer with a non-calendar plan year that begins within six months of the month HHS releases the current year FPL amounts can choose between using the prior or current year individual FPL amount for affordability calculation purposes. The FPL amounts historically increase year-over-year, so employers generally prefer to use the current year FPL amount when feasible. For open enrollment and other plan administrative reasons, it is generally difficult for employers with plan years beginning before April to take advantage of the current year individual FPL amount. An employer with a plan year beginning more than six months after the month HHS releases the data must use the current year FPL amount.

If applicable, employers should claim this safe harbor in lieu of the others since it does not rely on employee wages or hours worked.

Example 1

The 2022 individual FPL amount is $13,590. For a plan year beginning on January 1, 2023, an offer of coverage is affordable if the monthly employee cost of employee-only coverage is $103.28 or less.

($13,590 × 9.12%) = $1,239.40 annually

($1,239.40 ÷ 12) = $103.28/month

Example 2

Purely as a hypothetical, assume HHS releases the 2023 FPL amounts on January 27, 2023, and the individual amount increases to $14,035. An employer sponsors a plan with a plan year beginning on July 1, 2023. Using the hypothetical 2023 individual FPL amount, coverage is affordable for the July 1, 2023 – June 30, 2024 plan year if the monthly employee cost of employee-only coverage is $106.66 or less.

($14,035 × 9.12%) = $1,279.99 annually

($1,279.99 ÷ 12) = $106.66/month

The employer could rely on the 2022 FPL amount instead since that was still in effect six months before the July 1, 2023 plan year began, but $106.66/month is obviously greater than $103.28/month.

Form W-2 safe harbor

Under the Form W-2 safe harbor, coverage is affordable for plan years beginning in 2023 if the employee's share of the premium does not exceed 9.12% of wages reported in Box 1 of the employee's 2023 IRS Form W-2. Box 1 reports taxable compensation minus all pre-tax benefit deductions.

Employers can estimate Form W-2 earnings when pricing coverage, but actual affordability will not be certain until the end of the year and the actual W-2 is issued (i.e., 2023's W-2 will not be issued until January of 2024). The W-2 safe harbor is an all-or-nothing approach. An employer cannot rely on the W-2 safe harbor for part of the Form 1095-C reporting year and use a different safe harbor for the rest of the reporting year for the same employees. This may affect some employers with non-calendar year plans.

Example 1 below is probably the most familiar Form W-2 safe harbor calculation. It uses an actual or estimated W-2 amount as a benchmark to forecast the maximum employee-only contribution an employer can charge and fit within the safe harbor for employees at or above that Box 1 compensation amount.

Example 1

Using a Form W-2, Box 1 compensation amount of $18,000, an offer of coverage is affordable if the monthly employee cost of employee-only minimum value coverage is $136.80 or less.

($18,000.00 × 9.12%) ÷ 12 = $136.80/month

Example 2 follows the safe harbor calculation in the regulations, using actual Box 1 W-2 wages for the year. Employers should follow this style when appealing a later challenge that an offer of coverage did not meet the Form W-2 safe harbor for a particular FT employee. The Form W-2 safe harbor calculation pro-rates the Box 1 wages if the months worked exceed the months an employer offered coverage. This will apply if the plan has a waiting period or if the employee is not employed for the entire calendar year.

Example 2

An employee's actual 2023 Form W-2, Box 1 compensation is $23,444.53. The employee worked and the employer offered coverage for all 12 months. The monthly employee cost for the lowest cost, employee-only minimum value medical plan is $140.

Wages: $23,444.53 × (12 offered ÷ 12 worked) = $23,444.53   Annual Cost: $140 × 12 = $1,680

$1,680 ÷ $23,444.53 = 7.17%; coverage is affordable because 7.17% is less than 9.12%

Rate of pay safe harbor

The Rate of Pay safe harbor has two subparts for hourly and non-hourly employees, described below.

Hourly employees

Under the Rate of Pay safe harbor for hourly employees, coverage is affordable for plan years beginning in 2023 for a particular month if the employee's share of the premium for the lowest cost employee-only MV plan option does not exceed 9.12% of 130 paid hours multiplied by the lower of:

- The employee's hourly rate as of the first day their offer of coverage is effective during the plan year (the first day of the plan year for most employees); or
- The employee's hourly rate for that particular month.

Employers must multiply the applicable rate of pay by 130 hours regardless of the actual number of hours the employee works during any given month. This safe harbor bases the rate of pay on the employee's gross base rate of pay. This amount does not exclude any employee contributions toward benefits, but it does not account for bonuses, commissions, or tips. This safe harbor is impractical for employees that receive a significant amount of their compensation from those sources.

Example 1

An employer maintains a calendar year plan. On January 1, 2023, the employee's hourly rate is $12. The employee's hourly rate increases to $13.50 as of July 1st. An offer of coverage is affordable if the monthly employee cost of employee-only coverage is $142.27 or less.

(130 × $12) × 9.12% = $142.27 for all months

The increase to $13.50 does not apply, because the employee's hourly rate as of the first day of the plan year (the first day the offer of coverage was effective) remains the lowest applicable rate for calculation purposes.

Example 2

An employer maintains a calendar year plan. On January 1, 2023, the employee's hourly rate is $12. The employee's hourly rate decreases to $10 from June – August and then returns to $12 beginning in September. An offer of coverage is affordable if the monthly employee cost of employee-only coverage is equal to or less than the following calculated amounts:

(130 × $12) × 9.12% = $142.27 for January – May and September – December.

(130 × $10) × 9.12% = $118.56 for June – August

Non-hourly employees ("salaried employees")

Under the Rate of Pay safe harbor for salaried employees, coverage is affordable for plan years beginning in 2023 if the employee's share of the premium does not exceed 9.12% of the employee's gross monthly salary as of the first day their offer of coverage is effective during the plan year. For most employees, this will be the first day of the plan year.

Employers sponsoring non-calendar year plans will use the gross monthly salary applicable to the plan year beginning in 2023. This safe harbor is not available for a salaried employee if the employee's monthly salary decreases during the plan year (e.g. due to unpaid leaves of absences, demotion, etc.).

This safe harbor bases the rate of pay on the employee's gross monthly salary. This amount does not exclude any employee contributions toward benefits, but it does not account for bonuses or commissions. This safe harbor may be impractical for employees that receive a significant amount of their compensation from those sources.

Example

An employer maintains a calendar year plan. On January 1, 2023, the employee's monthly gross salary throughout the year is $3,000. An offer of coverage is affordable if the monthly employee cost of employee-only coverage is $273.60 or less.

$3,000 × 9.12% = $273.60/month

Form W-2 versus Rate of Pay safe harbor

The Rate of Pay safe harbor often appears more attractive than the Form W-2 safe harbor for planning purposes, because affordability under the Form W-2 safe harbor may not be certain for a number of employees until the end of the calendar year. There are still situations where the Form W-2 safe harbor is or may be preferable:

- Although Form W-2, Box 1 excludes pre-tax benefit deductions and the rate of pay safe calculation uses gross monthly pay, the Rate of Pay safe harbor calculation for hourly employees is fixed at 130 hours. The

Form W-2 safe harbor may produce better results for employees who work significantly more hours than this per month even accounting for payroll deductions.

- The Rate of Pay safe harbor does not include bonuses, commissions, tips, or overtime pay. If these forms of compensation make up a significant portion of an employee's pay, the Form W-2 safe harbor should produce better results.
- The Rate of Pay safe harbor is not available for salaried employees whose gross monthly salary decreases during the plan year.

The Extension to the Enhanced Marketplace Subsidies

As part of a broader COVID-19 relief package, the American Rescue Plan Act of 2021 (ARPA) enacted enhanced Marketplace subsidies for 2021 and 2022. The IRA extends the enhanced subsidies through 2025.

The following table compares the Marketplace subsidies in effect before ARPA with the enhanced subsidies.

Marketplace Subsidies – Percentage of Income Paid for 2nd Lowest Cost Silver Plan		
Income as Percentage of FPL	**Immediately Prior to ARPA**	**2021 through 2025**
<100%	Ineligible	Ineligible
100% – 138%	Ineligible if in Medicaid expansion state or 2.07% if not	0.00%
138% – 150%	3.10% – 4.14%	0.00%
150% – 200%	4.14% – 6.52%	0.00% – 2.00%
200% – 250%	6.52% – 8.33%	2.00% – 4.00%
250% – 300%	8.33% – 9.83%	4.00% – 6.00%
300% – 400%	9.83%	6.00% – 8.50%
>400%	Ineligible	8.50%

As you can see, the enhanced subsidies make the bronze and lower-cost silver medical plan options[8] available in the Marketplace free or nearly free for lower income FT employees who qualify for them. All bronze and silver options are also more attractive for individuals at higher income levels.

The enhanced subsidies increase the likelihood that FT employees who qualify will enroll in Marketplace coverage, which is the trigger for an employer mandate penalty. This increased exposure means employers should pay greater attention to the employer affordability safe harbors for 2023. At the same time, the affordability percentage applicable to those safe harbors drops from 9.61% in 2022 to 9.12% in 2023.

The enhanced subsidies may also disrupt the employer strategy of offering very low cost coverage that does not offer minimum value (often called "MEC" or "skinny" plans in the insurance industry) to employees instead of more traditional affordable, minimum value coverage.

[8] Bronze plan options have the lowest premiums and pay 60% of covered benefits for the plan year. Silver plan options have higher premiums and pay 70%.

The plan counts for the purposes of avoiding the IRC §4980H(a) “no offer” penalty since minimum value does not matter for that penalty. The strategy relies on employees enrolling in the plan instead of enrolling in subsidized Marketplace coverage to avoid the §4980H(b) “inadequate offer” penalty, where minimum value does matter. Historically, this strategy worked because the MEC plan premiums were much cheaper than subsidized Marketplace coverage. This is no longer the case for lower income workers.

Given the two to three year lag for the IRS to issue proposed employer mandate penalties, it may be 2024 before this becomes clear. Lastly, we do not expect Congress (or the IRS) to revise the affordability safe harbor percentage to match the top-end 8.50% Marketplace subsidy percentage of income limit.

About the author

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