Oregon Educators Benefit Board
Affordable Care Act (ACA) Bulletin #8-F

Spotlight on Health Care Reform
Prepared for Entities Participating in the OEBB Benefits Program

APPLICABLE TO EMPLOYEE GROUPS THAT RECEIVE A BENEFIT CONTRIBUTION WHICH CAN ONLY BE USED TO PURCHASE MEDICAL, DENTAL AND/OR VISION BENEFIT. THIS INCLUDES FLAT DOLLAR CONTRIBUTIONS (INSURANCE CAP) AND CONTRIBUTIONS REPRESENTING A PERCENTAGE OF THE PREMIUM AND EMPLOYEES IN THIS GROUP ARE NOT ELIGIBLE TO RECEIVE CASH FOR CHOOSING NOT TO ENROLL IN AN OEBB MEDICAL PLAN (I.E., EMPLOYEES ONLY HAVE THE OPTION TO "WAIVE" OEBB MEDICAL COVERAGE).

This bulletin will review the ACA Affordability safe harbor calculation when the only flexibility the employee has is to use the benefit contribution toward the purchase of medical, dental and/or vision coverages through OEBB. Affordability safe harbors are related to the Pay or Play penalties of the Shared Responsibility provisions of the Affordable Care Act (ACA).

Overview of ACA Requirements and the Play Penalty

The Affordable Care Act requires large employers to provide minimum essential coverage to full-time employees or face penalties (the Pay penalty). The coverage offered to employees must also qualify as "affordable" or the Play penalty may be triggered. The Play penalty assessed against an entity is prorated to $250 per month ($3,000 annually) for each employee who secures subsidized medical coverage from a public exchange AND for whom the coverage offered by the entity was deemed unaffordable. In this bulletin, we will review the three methods that entities may use to determine whether the coverage offered is deemed "affordable" according to the ACA. Additionally, we will review the impact of offering opt-out credits to the affordability calculations.

Definitions for this bulletin and the ACA affordability calculation purposes relevant in this bulletin

- **Opt-out Credit:** This term means a taxable benefit, such as cash, provided to an employee for electing not to enroll in the OEBB medical coverage available through the employing entity. **This bulletin has been prepared for employee groups who do NOT receive any type of benefit for opting out of the OEBB plan offered.** For examples of how opt-out credits are treated for affordability calculations, see OEBB Bulletins 8-A, 8-B, 8-C, 8-D or 8-E.

- **Employee Contribution:** For this bulletin, the term **employee contribution** means the amount of premium the employee is required to pay (usually through payroll deduction) for medical coverage. For purposes of the affordability calculations, the **Employee Contribution** is calculated based on the cost to cover the employee only on the lowest-cost plan available to the employee — even if the employee chooses a higher cost plan and/or enrolls family members. For example, if the total monthly cost for Employee-Only coverage for the lowest-cost plan offering is $353 and the Entity pays $300 towards the coverage, the Employee Contribution is $53 per month.

- **Flex Credits:** A flex-credit system is one in which the entity provides a lump sum or cap to the employee for purchasing a variety of benefit plans. In this bulletin, flex credits are used to purchase medical, dental and vision coverage only; therefore, the flex credits do not negatively affect an entity's affordability calculation. **See OEBB Bulletin 8-C or 8-E for examples of employee groups that can use the entity benefit contribution to purchase coverages other than medical, dental and/or vision or to have it contributed to a healthcare flexible spending account (HCFSA).**

Background

On February 10, 2014, the Internal Revenue Service (IRS) issued final regulations implementing the employer-shared responsibility provisions (otherwise known as the pay-or-play mandate) under the Patient Protection and Affordable Care Act (ACA). Additional guidance followed in the form of Internal Revenue Code Notices and FAQs. On November 26, 2014, the Minimum Essential Coverage and Other Rules Regarding the Shared Responsibility Payment for Individuals were issued. This guidance clarified a number of ACA key topics, including how minimum essential coverage is determined, the application of the play and pay penalties in 2015 and 2016, and affordability of coverage for the purposes of the ACA's individual mandate penalty. The individual mandate penalty is the ACA penalty generally requiring all individuals have medical coverage unless they qualify for an exemption such as having no affordable coverage options available to them (whether employer-provided coverage or through other sources).

The IRS has issued formal guidance on the affordability safe harbors applicable to the employer mandate penalty (also referred to as the Pay or Play penalties), which can be found here: http://www.irs.gov/Affordable-Care-Act/Employers/Questions-and-Answers-on-Employer-Shared-Responsibility-Provisions-Under-the-Affordable-Care-Act%20-%20.

During the last six months, the IRS has also provided verbal comments and clarifications in ACA-related conference calls which continue to impact the interpretation of these regulations. Written guidance on the treatment of flex credits and opt-out credits in the employer safe harbor affordability calculations have not been issued. The IRS has provided verbal guidance on several occasions regarding the treatment of both flex credits and opt-out credits. This bulletin will outline and describe the treatment of flex as verbally interpreted by the IRS and as understood by Towers Watson when performing safe harbor affordability calculations. OEBB hosted a webinar on March 19, 2015 for entities to review the specifics of the affordability safe harbors. A recording of this webinar can found on OEBB's website at: www.oregon.gov/oha/OEBB/Pages/ACA-Healthcare-Reform.aspx.

How are flex credits treated in the affordability calculations?

The November 26, 2014 regulations indicated that a flex credit applies toward the affordable coverage calculation for individual mandate penalty purposes if <u>all</u> the following are true:

(1) The employee does not have the option to take the flex credit as a taxable benefit (e.g., cash payment);

(2) The flex credit may be used to purchase minimum essential coverage; <u>and</u>

(3) The flex credit may only be used to pay for benefits providing medical care under IRC § 213.

Senior IRS officials have verbally indicated on several occasions that <u>the IRS believes this definition should also apply to employers</u> when determining whether an employer has met an employer affordability safe harbor for the purposes of avoiding the Play penalty, although it has yet to issue written guidance incorporating this position into the employer affordability safe harbor rules.

<u>Affordability Determinations</u>

How does an entity determine whether it offers affordable coverage?

An entity may avoid a potential Play penalty if it offers affordable coverage to its <u>full-time employees (FTE) as defined under the ACA</u>. Please see earlier OEBB bulletins for details about who qualifies as an FTE for ACA purposes.

Note: The Play penalty can only be assessed with respect to an FTE. As a result, affordability is only applicable to Full-time Employees as defined by the ACA.

<u>Affordability at the Individual Level</u>

An individual's eligibility for a subsidy in the public insurance marketplace depends on certain criteria including whether the individual was offered affordable coverage through another source. Qualifying for a federal subsidy in the marketplace is generally based upon an individual's household income.

<u>Affordability at the Employer Level</u>

The IRS recognized that determining affordability based upon household income would be very difficult for employers and issued three affordability safe harbor methods for determining whether an entity has offered affordable coverage to a Full-time Employee. As a result, affordability is determined based on what an employee would pay per month for employee-only coverage for the lowest-cost plan option <u>offered</u> by an entity, even if the employee elects a more expensive plan option. If offered by an entity, OEBB's Plan H would be the lowest-cost plan offered to its employees. For entities using composite rates, there are no special rules or exceptions for entities that would permit an entity to reflect only a portion of the composite rate as attributable to employee-only coverage when performing affordability calculations. The entire monthly composite rate for the lowest-cost plan option offered would have to be used. Employees who are at the lower end of the pay scale are more likely to present affordability issues if the entity uses a composite premium rate structure. For entities using tiered rates, affordability is determined on the employee-only rate tier.

Many entities will elect to use the same safe harbor method for all of its employees. However, an entity may choose to use more than one of the following safe harbors for its employees. An entity may vary the use of safe harbors for any "reasonable category of employees." These categories include specific job category (e.g., classified, administrators, etc.), hourly/salaried status or other similar bona fide business criteria. For example, it would be reasonable for an entity to use one approach for hourly employees and another approach for salaried employees, if necessary. The three affordability safe harbor methods are as follows:

1. Federal Poverty Level (FPL) Safe Harbor

An entity satisfies the FPL safe harbor if the employee is offered a plan for which the monthly premium for employee-only coverage is less than 9.5% of the Federal Poverty Level for a single individual, divided by 12. Entities are permitted to use the most recent published poverty guidelines as of the first day of the plan year of the applicable large employer's health plan. The final regulations clarified that with the FPL safe harbor, entities can use the guidelines in effect six months prior to the beginning of the plan year in order to give entities enough time to establish premium amounts in advance of the plan's open enrollment period. <u>For 2015, a plan option will be affordable under the FPL safe harbor if the Employee Contribution is less than $93.18 per month</u>. The FPL is increased annually but typically by a small amount and the safe harbor value shouldn't change by more than $2 – $3 from one year to the next. This safe harbor method is the easiest to use administratively since it does not rely on determining the employee's compensation.

2. Form W-2 Safe Harbor

An entity satisfies the W-2 safe harbor if the employee is offered a plan for which the required annual premium contribution by the employee for employee-only coverage is less than 9.5 percent of that employee's wages for that calendar year, as reported in Box 1 of Form W-2. Note that Box 1 of the Form W–2 <u>excludes</u> elective deferrals that an employee makes into an Internal Revenue Code (IRC) § 401(k) plan or § 403(b) plan, and also excludes amounts that an employee elects to contribute on a pre-tax basis for qualified benefits under a cafeteria plan or a commuter benefits plan. An entity will not know the true Box 1 value until the end of the calendar year but an entity should be able to reasonably estimate these values when running internal affordability calculations. Note: This method understates an employee's income in comparison to the method used to calculate income in the third safe harbor as described below.

3. Rate of Pay Safe Harbor

An entity satisfies the rate-of-pay safe harbor if the employee is offered a plan for which the monthly premium contribution by an employee for employee-only coverage is less than 9.5% of his or her monthly rate of pay.

a. For *hourly* employees, coverage is affordable if it is less than 9.5% of the employee's hourly rate of pay multiplied by 130 hours. The hourly rate of pay used for a given calendar month is the lower of the employee's hourly rate as of the first day of the plan year (October 1st for most entities) or during the calendar month. In other words, the hourly rate can decrease for calculation purposes throughout the year, but it cannot increase from the hourly rate as of the first day of the plan year.

b. For *salaried* employees, coverage is affordable if it is less than 9.5% of the employee's monthly salary. The rate of pay safe harbor is not available if an employee's monthly salary is reduced during the plan year. Solely for this purpose, an entity may use any reasonable method for converting payroll periods to monthly salary.

The rate of pay safe harbor doesn't exclude elective deferrals and should produce the highest compensation values for affordability calculation purposes. However, it is more administratively complex than either the Federal Poverty Level or W-2 safe harbors.

<u>Examples</u>

Below are some examples that illustrate an entity's affordable coverage calculations when the entity contribution is limited to medical, dental, and/or vision coverage:

Example 1: Employee Group uses tiered rates; employees may use the entity benefit contribution for medical, dental and/or vision coverage only AND cannot opt-out of OEBB medical coverage.
Entity A offers all OEBB medical plans. Plan H is the lowest-cost plan, and total premium amount for Employee-Only coverage for Plan H is $353 per month. The entity contributes $300 per month which can be applied toward medical, dental and/or vision coverage ONLY. (For examples in which employees can use their employer contribution toward HCFSA, HSA funds and/or life/disability insurance, see OEBB Bulletins 8-B, 8-C or 8-E.)
Affordability Calculation
According to the affordability calculation rules, the employee's contribution for Plan H (Employee-Only coverage) is $53 per month.
• FPL safe harbor is satisfied because the $53 per month opt-out credit is less than $93.18.

Example 2: Employee Group uses composite rates; employees may use the entity benefit contribution for medical, dental and/or vision coverage only AND cannot opt out of OEBB medical coverage.

Entity B offers all OEBB medical plans. Plan H is the lowest-cost plan and total premium amount for Employee-Only coverage for Plan H is $860 per month. The Entity contributes up to $800 per month which can be used to purchase medical, dental and/or vision coverage ONLY.

Affordability Calculation

According to the affordability calculation rules, the employee’s contribution for Plan H (Employee-Only coverage) is $60 per month.

- FPL safe harbor is satisfied because $60 is less than $93.18.

Example 3: Employee Group is offered all plans on a tiered rate structure and pay a percentage of the premium.

Entity C offers all OEBB plans. Plan H is the lowest-cost plan, and total premium amount for Employee-Only coverage for Plan H is $353 per month. The Entity contributes 90% of the cost of the medical plan for employee selecting Plan H with Employee Only coverage.

Affordability Calculation

According to the affordability calculation rules, the employee’s premium share for Plan H (Employee-Only coverage) is $35.30 per month.

- FPL safe harbor is satisfied because $35.30 is less than $93.18.

Example 4: Employee Group is offered all plans on a composite rate structure and pays a percentage of the premium

Entity D offers all OEBB plans. Plan H is the lowest-cost plan, and total premium amount for Employee-Only coverage for Plan H is $860 per month. The Entity contributes 85% of the cost of the medical plan for employee selecting Plan H with Employee Only coverage.

Affordability Calculation

According to the affordability calculation rules, the employee’s premium share for Plan H (Employee-Only coverage) is $129 per month.

- FPL safe harbor is not satisfied because $129 is greater than $93.18.
- Using the W-2 safe harbor, the coverage is affordable for an individual with approximately $16,295 or higher in annual compensation as reported in Box 1 of the W2 (($129/0.095) x 12 = $16,295).
- Using the Rate of Pay safe harbor (hourly employees), the coverage is affordable for an individual with a rate of pay of $10.45 per hour or higher (($129/0.095)/130 hour) = $10.45).

- For employee groups who can apply the Entity’s benefit contribution toward only the cost of medical, dental and/or vision coverages and the entity offers employees a benefit or credit to opt out of OEBB coverage, see OEBB Bulletin 8-A.

- For employee groups who can apply the Entity’s benefit contribution toward only the cost of medical, dental and/or vision coverages and can elect to have a portion of the contribution go into a health care flexible spending account (HCFSA) and who are eligible for a cash incentive for opting out of OEBB medical coverage, see OEBB Bulletin 8-B.

- For employee groups who can apply the Entity’s benefit contribution toward the cost of life, disability, accidental death and dismemberment and/or long term care, please refer to OEBB Bulletin 8-C which focuses on “flex credits” with these types of benefits and the impact on affordability calculations. If the flex credit system includes options to purchase benefits such as life or disability coverage or can elect to have a portion of the contribution go into a Health Savings Account, this presents additional challenges.

- For employee groups who can apply the Entity’s benefit contribution toward only the cost of medical, dental and/or vision coverages and who are eligible for either a cash incentive or HRA/VEBA contribution for opting out of OEBB medical coverage, see OEBB Bulletin 8-D.

- For employee groups who can apply the Entity's benefit contribution toward the cost of medical, dental and/or vision coverages only and can elect to have a portion of the contribution go into a Health Savings Account (HSA) and who are eligible for a cash incentive for opting out of OEBB medical coverage, see OEBB Bulletin 8-E

<u>Frequently Asked Questions</u>

1. *Does the affordable coverage calculation issue apply to all employees?*

   No. An entity cannot be assessed a penalty for a failure to offer affordable coverage to an individual who does not meet the definition of a full-time employee under the ACA. An entity is welcome to run the calculation on all employees, and the FPL safe harbor accomplishes this automatically, if applicable. The potential for a "play" penalty under the ACA (this is the $3,000 per year per affected individual penalty) can occur if an entity does not offer affordable coverage to an FTE (as defined by the ACA) who applies for and qualifies for subsidized coverage in the public insurance marketplace.

   The issue of affordable coverage is not relevant for the ACA's "pay" penalty (this is the $2,000 per year per all FTEs penalty).

   Please note: If an entity offers affordable coverage to an employee (whether full-time or part-time), the employee will lose the ability to qualify for subsidized coverage in the public insurance marketplace.

2. *Do we need to be concerned with affordability issues for employees who waive coverage?*

   Maybe. If an employee chooses not to enroll in an OEBB medical plan (either through waiving or opting out of coverage) and enrolls in the marketplace, this does not remove an FTE from an entity's potential penalty risk pool. The coverage offered to the employee who waived or opted out must have been deemed affordable in order for penalties to be avoided.

   Many entities only permit an FTE to waive coverage if they are enrolled in another group medical plan and the OEBB rules require the employee to be covered on another employer-sponsored medical plan to opt out of coverage (e.g., through a spouse's employer). An individual actually enrolled in other affordable medical coverage (including Medicare and Medicaid) cannot qualify for subsidized coverage in the marketplace and cannot trigger the "play" penalty against the entity. Due to the potential penalty risk, the entities may consider requiring substantiation of other coverage (if you do not already). An individual employed by more than one employer may also have access to affordable coverage elsewhere preventing subsidy eligibility.

3. *Can you provide an example where the FPL safe harbor will not work?*

   Yes. The FPL safe harbor will not work if the monthly cost of employee-only coverage for the lowest-cost medical plan available to the employee is greater than 9.5% of the FPL for that year. In 2015, the FPL safe harbor will not work if the employee contribution for the lowest-cost medical plan available is greater than $93.18 per month for employee-only coverage. If an entity does not offer an OEBB medical plan option with a contribution level below this amount, the FPL safe harbor will not be satisfied. Remember that the FPL itself increases a little each year, so the safe harbor value will also increase a little each year.

4. *Is affordable coverage based only on medical insurance, or does other coverage such as vision and dental insurance count?*

   For the entities, the affordable coverage rules apply solely to the cost of medical coverage. If medical, dental and vision were bundled under a single insurance policy at a single employee contribution rate without the ability to separately elect or waive them, they would all count together for affordability purposes. In that instance, they would also already be treated as a single employee contribution.

5. *When an employee declines coverage, we contribute the unused entity contributions we would have spent on their coverage toward a pool that is used to reduce the contributions of our participating employees. Can we use this reduced contribution amount for affordable coverage calculation purposes?*

   We believe an entity can use the reduced contribution amount (after the funding in the pool is distributed) for affordability calculation purposes. The use of a pool may mean that the cost of coverage provided to the FTEs and reported to the IRS on IRS Form 1095-C can fluctuate from month-to-month which may present an administrative challenge.

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