

JUNE 15, 2016

**AFFORDABLE CARE ACT COMPLIANCE UPDATE:
EMPLOYER “PAY OR PLAY” PENALTIES AND “AFFORDABILITY” PERCENTAGES
BOTH INCREASED FOR INFLATION**

Although the regulatory environment surrounding the Affordable Care Act has been mercifully quiet this year – providing employers and employee benefit practitioners a brief chance to catch their breath – the IRS did announce a number of important changes late last year that affect all employers with at least fifty full-time employees (i.e., “Applicable Large Employers”). This Alert will focus on a few of these new rules, as announced by the IRS in its Notice 2015-87.

I. – Employer “Shared Responsibility” Penalties Increased for Inflation

Under the Affordable Care Act’s final “shared responsibility” provisions (also known informally as the employer “pay or play” mandate), Applicable Large Employers must offer affordable, minimum value health coverage to their full-time employees. If they don’t, they may be exposed to a non-deductible “shared responsibility” penalty.

If the employer fails to offer any coverage – whether “affordable” or not – to at least 95% of its full-time employees, and at least one full-time employee enrolls in subsidized coverage on the Exchange, the employer will be subject to a so-called “sledgehammer” penalty. This penalty is calculated each month by multiplying a specific dollar figure (discussed below) for every full-time employee in the employer’s company, although the first thirty full-time employees are disregarded in the calculation.

If, on the other hand, an Applicable Large Employer *does* offer coverage to at least 95% of its full-time employees, but the coverage is not affordable, then the employer will be subject to a so-called “tack-hammer” penalty. This penalty is calculated each month by multiplying a separate dollar figure (discussed below) for just those specific full-time employees to whom affordable coverage was not offered and who are receiving subsidized coverage on the Exchange during that month.

The original amount of the “sledgehammer” penalty was \$166.67/month, or \$2,000/year, for each full-time employee. The original “tack-hammer” penalty amount was \$250/month, or \$3,000/year. These penalties, however, are indexed for inflation. The adjusted penalty amounts are set forth in the chart below:

	2014 Amount (Original Amount)	2015 Amount	2016 Amount	2017 Amount
Sledgehammer Penalty	\$166.67/month (\$2,000.00/year)	\$173.33/month	\$180.00/month	\$188.33/month (\$2,260.00/year)
Tack-hammer Penalty	\$250.00/month (\$3,000.00/year)	\$260.00/month	\$270.00/month	\$282.50/month (\$3,390.00/year)

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II. – Percentages for “Affordability” Calculation Are Now Indexed for Inflation

In order to avoid potential exposure to the tack-hammer penalty, an Applicable Large Employer must offer minimum value, “affordable” coverage to all of its full-time employees. “Affordability” is determined by looking at what the employee is required to pay for employee-only coverage under the employer’s least expensive group health plan that provides minimum value.

As originally enacted by Congress, the Affordable Care Act deemed an employer to have offered “affordable” coverage if its employee’s share of the cost of health care coverage was no greater than 9.5% of the employee’s household income. Because most employers have no way of knowing their employees’ total household income, the IRS provided three different affordability “safe harbors” that employers may use:

- The Federal Poverty Level Safe Harbor;
- The Form W-2 Safe Harbor; or
- The Rate of Pay Safe Harbor.

An employer that uses one or more of these safe harbors will know with certainty that it will not have any exposure to the tack-hammer penalty, so long as all the conditions of the safe harbor have been satisfied, including the requirement that the employer subsidize employees’ health care coverage to the degree required under the safe harbor.

Late last year, the IRS announced in Notice 2015-87 that the percentage used in determining affordability under these safe harbors will now be indexed for inflation. As a result, the affordability percentage will increase each year, as shown in the following table:

	2014	2015	2016	2017
Safe Harbor Affordability Percentage	9.5%	9.56%	9.66%	9.69%

Bear in mind that the applicable percentage applies on a *plan year basis*, so non-calendar year plans don’t have to worry about adjusting their premiums in the middle of the plan year in order to stay affordable.

Needless to say, the legal issues raised in this Alert are very complex, and we have abbreviated our explanations both for space reasons and to ensure you don’t doze off while reading. If you need any further clarification or have any questions regarding health care reform compliance for employers, please feel free to call [Eric Namee](#), [Steven Smith](#), or [Brad Schlozman](#) at (316) 267-2000.