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Affordable Care Act Compliance Update: Employer "Pay or Play" Penalties Increase, But "Affordability" Percentage Decreases in 2018

Although the regulatory environment surrounding the Affordable Care Act continues to remain mostly silent this year – providing all of us a welcome respite from the chaotic whirlwind of activity over the last few years – the IRS did announce a number of important changes that will affect all employers with at least fifty full-time employees (i.e., "Applicable Large Employers"). This Alert will focus on the changes announced by the IRS in its Revenue Procedure 2017-36.

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:

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	2014 Amount (Original Amount)	2016 Amount	2017 Amount	2018 Amount
Sledgehammer Penalty	$166.67/month ($2,000.00/year)	$180.00/month ($2,160.00/year)	$188.33/month ($2,260.00/year)	$193.33/month ($2,320.00/year)
Tack-hammer Penalty	$250.00/month ($3,000.00/year)	$270.00/month ($3,240.00/year)	$282.50/month ($3,390.00/year)	$290.00/month ($3,480.00/year)

We have not heard any reports of enforcement of these penalties by the IRS. But we have heard that the IRS is supposedly working to calibrate its computer system with the Forms 1094 and 1095 that employers have been filing for the last few years. Some insiders to whom we have spoken suggest – for whatever it's worth – that IRS enforcement may be coming soon. Whatever is the truth, to be forewarned is to be forearmed.

II. - <u>Percentage for "Affordability" Calculation Decreases in 2018 - Some Employer Subsidies May Need to Increase to Remain Affordable</u>

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.

The IRS previously announced that the percentage used in determining affordability under these safe harbors will be indexed for inflation. Until now, every year, the affordability percentage increased. But in 2018, the affordability percentage actually decreases (from 9.69% to 9.56%). That means that, even if the cost of coverage in the employer's plan remains exactly the same, the employer's required minimum subsidy to keep that coverage "affordable" for its employees will increase.

<u>Example:</u> Assume that the total (unsubsidized) premium for individual coverage in an employer's plan is $500. Further assume that the employer is using the Rate of Pay Safe Harbor and an employee's hourly rate is $10.00/hour. In 2017, the employer could have charged the employee a premium of no more than $125.97 [130 hours x $10/hours x 0.0969], which means the employer would have to kick in at least $374.03 per month for this employee. But in 2018, the employer will be able to charge the same employee no more than $124.28 [130 hours x $10/hours x 0.0956], which means the employer would have to kick in at least $375.72 per month for this employee.

The table below reflects the changes in the "affordability" percentage over the last five years:

	2014	2015	2016	2017	2018
Safe Harbor Affordability Percentage	9.5%	9.56%	9.66%	9.69%	9.56%

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.

The good news for employers is that the Federal Poverty Level for a single individual, which is used to determine the Federal Poverty Level Affordability Safe Harbor, has increased, as reflected in the table below:

Calendar Year	Applicable FPL	Affordability Percentage	Maximum Employee Contribution
2018	$12,060	9.56%	$96.08/month
2017	$11,880	9.69%	$95.93/month
2016	$11,770	9.66%	$94.75/month

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.

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