Employee Benefits Compliance: Affordability

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Today’s Speaker

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Affordability Under the ACA– A Review

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ACA Employer Mandate

AKA "Employer Shared Responsibility," AKA "Pay or Play"...

ACA requires an Applicable Large Employer (ALE) to offer Minimum Essential Coverage that provides Minimum Value and is Affordable to its Full-Time Employees.

ACA Employer Mandate: Applicable Large Employers

What is an Applicable Large Employer (ALE)?

An employer is an ALE for the calendar year if the employer employed an average of at least 50 full-time employees (including full-time equivalents) during the preceding calendar year.

ACA Employer Mandate: Full-Time Employees

Who is a full-time employee? A full-time employee (FTE) is one that works, on average, 30 hours/week (or 130 hours/month).

- What is a full-time equivalent? This is a method of counting part-time employees for purposes of determining ALE status only. It does not require employers to offer coverage to part-time employees.
  - Formula: To determine the number of full-time equivalents, an employer adds the total number of hours worked by all part-time employees in a month and divides by 120.

ACA Employer Mandate: Full-Time Equivalent

Example:

Dunder Mifflin paper company has 40 full-time employees and 10 part-time employees who each work 80 hours per month.

1. Adding up the total number of hours worked by all part-time employees—

   10 part-time employees x 80 hours each = 800 total hours

2. Dividing by 120—

   $\frac{\text{800 total hours}}{120}$ = 6.66 (round down for # of equivalent employees)

Dunder Mifflin therefore has 40 full-time employees and 6 full-time equivalent employees, for a total of 46. Dunder Mifflin in this example is not an ALE, because an ALE must have at least 50 full-time employees plus full-time equivalents.

ACA Employer Mandate

What does an ALE have to do? An ALE has to offer FTEs group health Minimum Essential Coverage (MEC) that is Affordable and provides Minimum Value.

- Coverage has Minimum Value when the plan has an actuarial value of 60% or more.
- Coverage is Affordable if the employee's required contribution for self-only coverage does not exceed 9.02% (2025) of their household income. (9.96% in 2026)
  - Employers may rely on the contribution rate for employee-only coverage for the least expensive, minimum value medical plan.
- How does an employer figure out whether the plan is Affordable for employees?
  - 3 Safe Harbors:
    - W-2 Wages
    - Rate of Pay
    - Federal Poverty Line (FPL)

Affordability Safe Harbors: W-2 Wages

W-2 Wages: The employee's required contribution for calendar year 2025 does not exceed 9.02% of the employee's income as reported in Box 1 of the 2025 Form W-2. (9.96% for calendar year 2026)

Notes:

- Box 1 shows taxable wages, tips, and other compensation, but does not include elective deferrals to retirement plans or benefits paid with pretax dollars.
- To be eligible for this safe harbor, the employee's required contribution must remain a consistent amount or percentage of all Form W–2 wages during the plan year.

Affordability Safe Harbors: W-2 Wages

Example:

Homer is paid an annual salary of $30,000 by the Springfield Nuclear Power Plant, which also offers him MEC at a monthly cost of $210 for self-only coverage.

- Under this safe harbor, Homer’s monthly contribution must be less than $225.50:

  $30,000 income x 9.02% threshold / 12 months = $225.50 safe harbor

  $210 contribution < $225.50

- However, in a rare fit of forward thinking, Homer chose to contribute 10% of his earnings to his 401(k) account. Therefore, his Box 1 W-2 earnings will be reduced by $3,000. So, at the end of the year, the coverage will not be affordable based on the W-2 safe harbor:

  $27,000 Box 1 W-2 earnings x 9.02% threshold / 12 months = $202.95 safe harbor

  $210 contribution > $202.95

Affordability Safe Harbors: W-2 Wages

Advantages:

- Employer can use all hours worked by the employee and the employee's taxable income.
- Often permits the employer to charge employees a higher monthly premium.

Disadvantages:

- Employee pre-tax deferrals will reduce Box 1 earnings amount.
- Difficult to predict affordability using this safe harbor because the calculation is ultimately made after the end of the calendar year.

Affordability Safe Harbors: Rate of Pay

Rate of Pay: The monthly contribution does not exceed 9.02% (9.96% for plan years beginning in 2026) of the employee’s lowest hourly rate of pay multiplied by 130 hours or the employee’s monthly salary.

- The lowest hourly rate of pay is the rate of pay at the start of the coverage period or the current month’s rate, if lower.
- For non-hourly employees, the calculation is based on the employee’s monthly salary as of the start of the coverage period.

Affordability Safe Harbors: Rate of Pay

Example:

Woody the bartender is a non-exempt employee earning $10.00 an hour. The corporation that owns Cheers (the bar where Woody works) offers MEC with an employee monthly contribution for self-only coverage of $122.50. The rate of pay safe harbor would set a maximum contribution for Woody of $117.26. Here, the coverage is not Affordable, because the contribution for self-only coverage under the plan is higher than the safe harbor.

$10.00 hourly rate x 130 hours x 9.02% threshold = $117.26 safe harbor

$122.50 single coverage contribution > $117.26

Affordability Safe Harbors: Rate of Pay

Advantages:

- Predictability. Since the calculation is based on the rate of pay, fluctuations in hours worked don't impact it.
- Able to be estimated for next plan year based on current rates of pay.

Disadvantages:

- Creates lower Affordability threshold than W-2.
- If employees work a lot of overtime, employer can't include that extra income in safe harbor.

Affordability Safe Harbors: Federal Poverty Level

Federal Poverty Level (FPL): The employee's monthly contribution does not exceed 9.02% (9.96% for plan years beginning in 2026) of the FPL for a single individual based on guidelines in effect up to six months prior to the start of the plan year, divided by 12.

Example: The FPL for a single individual in 2025 is $15,650.

9.02% threshold x $15,650 FPL = $1,411.63

1,411.63 / 12 months = $117.63

Maximum employee contribution for lowest-cost self-only plan is $117.63/month.

Affordability Safe Harbors: Federal Poverty Level

Advantages:

- "Safest" safe harbor because the amount isn't affected by employee's hourly rate of pay, number of hours worked or total income at the end of the year.
- Allows ALE to use simplified reporting on 1095-C forms.

Disadvantages:

- Calendar year plans typically will not know that plan year's FPL until mid-January, after the plan year has begun.
- Most expensive option for employers. Not every employer will be able to afford such low employee contributions.

Affordability Safe Harbors: Impact of Opt-Out Arrangements

Opt-out arrangements, AKA “cash in lieu” can create affordability headaches if not done correctly.

Rule: The amount of the opt-out credit must be added to the employee share of the lowest-cost plan providing minimum value, unless it is an eligible opt-out arrangement.

In an eligible opt-out arrangement, employer must:

- Offer the opt-out as an electable benefit option under its Section 125 plan,
- Require employee to decline the medical plan in order to get the incentive, and
- Require the employee to provide reasonable evidence at enrollment (which can be an attestation) that employee and dependents will have MEC under a group health plan (not individual market coverage) for the plan year.

Affordability Safe Harbors: Opt-Out Example

Chilton Academy uses the Form W-2 Safe Harbor in 2025. Under this Safe Harbor, teacher Max Medina's coverage is affordable if his required contribution does not exceed 9.02% of Max's Form W-2 wages for the calendar year. The employee-only premium for Chilton's lowest-cost self-only coverage is $200/month.

Max's Form W-2 wages for the calendar year are $30,000. Therefore, for Chilton to meet the Form W-2 Safe Harbor, Max's required contribution may not exceed $237.50/month.

$30,000 W-2 wages x 9.02 threshold / 12 months = $237.50/month safe harbor

Chilton's $200/month premium < $237.50/month

But what if Chilton also offers $50-per-month payment if Max declines medical coverage?

Affordability Safe Harbors: Opt-Out Example

If Chilton offers a $50/month opt-out, (and doesn't follow the rules for an eligible opt-out,) then the premium for the lowest cost coverage is actually $250/month.

$200 lowest cost single-only premium + $50/month opt-out = $250/month

$30,000 W-2 wages x 9.02 threshold / 12 months = $237.50/month safe harbor

Chilton's $250/month premium > $237.50/month

If Chilton offers a $50/month opt-out, then the coverage is not Affordable to Max under the Form W-2 Safe Harbor.

Choosing Affordability Safe Harbors

Employers are not required to choose safe harbors until they are preparing Forms 1095-C, however, many like to consider the safe harbors when setting contributions.

ALEs may apply different safe harbors to various categories of employees, as long as these categories are reasonable and the safe harbors are used consistently within each group.

- Examples of reasonable categories: specific job types, nature of compensation (hourly or salary), geographic location, and similar bona fide business distinctions.
- Employers may choose to apply any of the safe harbors for any reasonable category of employees, provided they do so on a uniform and consistent basis for all employees in a category.

Penalties Under §4980H– (a) Penalty

- Rule §4980H(a) – ALEs must offer minimum essential coverage (MEC) to at least 95% (or all but 5, if ALE has 50-99 FTEs) of full-time employees and their dependent children each month. An offer of coverage is not required for spouses.
- Penalty will apply if any FTE enrolls through a public Marketplace and qualifies for a premium tax credit (or tax subsidy).

Penalty calculation = (full-time employee count – 30) x §4980H(a) penalty

Penalties Under §4980H– (b) Penalty

- Rule §4980H(b) – ALEs must offer coverage that provides minimum value AND is affordable to all full-time employees each month.
  - No 5% “margin of error” for §4980H(b) requirements as under §4980H(a)
  - Penalty applies on a per-employee basis rather than against the total full-time employee count
- Penalty will apply per FTE not offered minimum-value, affordable coverage who enrolls through a public Marketplace and qualifies for a premium tax credit (or tax subsidy).

Penalty calculation = §4980H(b) penalty x number of full-time employees who are not offered minimum-value, affordable coverage and who enroll through a public Marketplace and qualify for a premium tax credit

IRS Enforcement

- IRS Letter 5699
  - Letter issued to employers who appear to be applicable large employers (ALEs) based on number of Form W-2s filed but didn't submit employer reporting
  - IRS is currently sending letters for 2023 reporting
  - Penalty for 2025 is $340/form (x 2 if both failed to file and failed to furnish)

- IRS Letter 226J
  - Letter issued to ALEs to notify them that they may be liable for an Employer Shared Responsibility Payment (ESRP), aka § 4980H(a) and (b) penalties
  - IRS currently wrapping up enforcement for 2022 reporting
  - ALEs are given instructions on next steps for ESRP computations, penalty payments, or steps to dispute

Recent Developments

Faulk Company, Inc. v. Becerra – Texas janitorial firm that decided not to offer employee coverage was assessed a penalty for 2019 via IRS letter 226J received in December 2021. Faulk disagreed with penalty and paid “under protest,” followed by filing refund claim for penalty amount in 2022. Brought suit in Northern District of Texas Forth Worth Division in 2024. Court granted plaintiff summary judgment on April 10, 2025. Federal government has appealed.

IRS lacked the authority to issue the certification necessary for imposing the ACA penalties § 4980H(a). ACA gives certification authority to HHS, not IRS and HHS cannot delegate. IRS ordered to refund penalty.

- Huge potential impact for employers
  - Potential new process for penalties going forward
  - Potential opportunity to seek refunds for penalties assessed in the past

Affordability: Planning for 2026

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2026 Affordability Threshold

Affordability threshold for plan years beginning on or after January 1, 2026 is 9.96%.

- Up from 9.02% for plan years beginning on or after January 1, 2025
  - Highest percentage since 2015 means that health plan premiums have risen faster than wages
  - Higher percentage → easier to offer coverage deemed Affordable

2026 Affordability Safe Harbors

FPL Safe Harbor

2025 Plan Years	2026 Plan Years
$113.20/month	$129.90/month

Rate of Pay Safe Harbor

Pay	2025	2026
$10/hour	$117.26/month	$129.48/month
$15/hour	$175.89/month	$194.22/month
$20/hour	$234.53/month	$258.96/month
$2,000/month	$180.40/month	$199.20/month
$4,000/month	$360.80/month	$398.40/month
$8,000/month	$721.60/month	$796.80/month

2026 Affordability Safe Harbors

Form W-2 Safe Harbor

Form W-2, Box 1	2025	2026
$20,000	$150.33/month	$166.00/month
$30,000	$225.50/month	$249.00/month
$40,000	$300.67/month	$332.00/month
$50,000	$375.83/month	$415.00/month
$60,000	$451.00/month	$498.00/month
$70,000	$526.17/month	$581.00/month

§ 4980H Penalty Amounts For Calendar Year 2026

Penalty	2025		2026	
(a) penalty	$2,900.00/year	$241.67/month	$3,340.00/year	$278.33/month
(b) penalty	$4,350.00/year	$362.50/month	$5,010.00	$417.50 month

Impact of Federal Pullback in Subsidies

Percent of Income Paid for Marketplace Benchmark Siver Premium, by Income		
Income (% of FPL)	**ACA (pre-expanded subsidy and after 1/1/26)**	**During expanded subsidies (2021-2025)**
Under 100%	Not generally eligible for subsidies	Not generally eligible for subsidies
100-138%	2.07%	0.0%
138-150%	3.10-4.14%	0.0%
150-200%	4.14-6.56%	0.0-2.0%
200-250%	6.52-8.33%	2.0-4.0%
250-300%	8.33-9.83%	4.0-6.0%
300-400%	9.83%	6.0-8.5%
Over 400%	Not eligible for subsidies	8.5%

Source: Kaiser Family Foundation, https://www.kff.org/affordable-care-act/issue-brief/impact-of-key-provisions-of-the-american-rescue-plan-act-of-2021-covid-19-relief-on-marketplace-premiums/

Impact of Federal Pullback in Subsidies

- Average net premium increase of more than 75% for enrollee premium payments in the Marketplace.
- CBO projects that on average, gross benchmark silver premiums will ultimately be 7.9% higher than they would otherwise be because of sicker risk pool.
- Recent Kaiser Family Foundation (KFF) analysis of rate filings for 2026 show median proposed premium increase of 18%; on average, ACA Marketplace insurers are raising premiums by about 20% in 2026.
  - Other factors: rising Rx costs, impact of tariffs
- Higher marketplace premiums + lack of subsidies = fewer people getting subsidized coverage
  - May lead to less penalty exposure for some employers

Planning for 2026

- Analyze affordability for next plan year using the data you have
  - Use 2026 Affordability threshold
  - Use 2025 FPL if first day of the plan year is before 7/1/26
  - Use most recent employee pay data
- Analyze plan design contribution strategies
  - Consider pay-based contribution structure
  - Offer lower-cost MEC plan option
  - Lower employee premium contributions
  - Look at impact of opt-out program

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Questions

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Thank you!