ACA COMPLIANCE OVERVIEW

Health Plan Affordability: Avoiding Common Mistakes

The Affordable Care Act (ACA) requires applicable large employers (ALEs) to offer affordable, minimum value health coverage to their full-time employees or pay a penalty. This employer mandate provision is also known as the "pay-or-play" rules.

Under the pay-or-play rules, an ALE's health coverage is considered affordable if the employee's required contribution to the plan does not exceed 9.5% (as adjusted) of the employee's household income for the taxable year. Because an employer generally will not know an employee's household income, the IRS has provided three optional safe harbors ALEs may use to determine affordability based on information that is available to them. Before the start of each plan year, ALEs should confirm that at least one health plan option offered to full-time employees will satisfy the applicable affordability percentage using one or more of the safe harbors.

This Compliance Overview addresses common mistakes ALEs should avoid when determining health plan affordability under the ACA's pay-or-play rules.

LINKS AND RESOURCES

- IRS final regulations on the ACA's pay-or-play rules
- IRS final regulations addressing wellness program incentives and affordability
- IRS Notice 2015-87 and proposed regulations addressing opt-out payments and affordability

Adjusted Percentage

The affordability percentage is adjusted each year based on the rates of health coverage premium growth relative to the rates of income growth. The adjusted affordability percentage is:

- 8.39% for plan years beginning in 2024;
- 9.02% for plan years beginning in 2025; and
- 9.96% for plan years beginning in 2026.

Safe Harbors

The IRS has provided three safe harbors ALEs may use to determine their health plan's affordability:

1. Form W-2 safe harbor;
2. Rate-of-pay safe harbor; and
3. Federal poverty line (FPL) safe harbor.

An ALE may choose to use one or more of the safe harbors for all its employees or for any reasonable category of employees, provided it does so on a uniform and consistent basis.

1. Mistake: Offering Affordable Health Coverage Only to Employees Working 40 or More Hours Per Week

ALEs may be assessed with penalties if they do not offer affordable health coverage to their full-time employees. Identifying full-time employees is a key step to avoiding penalties under the ACA's pay-or-play rules. Under these rules, a full-time employee is, for a calendar month, an employee employed on average at least **30 hours of service per week, or 130 hours of service per month**. ALEs may owe a penalty if they do not offer affordable, minimum-value health coverage to these employees, regardless of how the employer defines full-time employment for other purposes.

The IRS has provided two methods for determining full-time employee status—the monthly measurement method and the look-back measurement method. Under the monthly measurement method, the employer determines if an employee is a full-time employee on a month-by-month basis by looking at whether the employee has at least 130 hours of service for each month. Under the look-back measurement method, an employer may determine the status of an employee as a full-time employee during what is referred to as the stability period, based upon the hours of service of the employee in the preceding period, which is referred to as the measurement period.

2. Mistake: Applying the Affordability Test to All Health Plan Coverage Tiers

The affordability of an ALE's health coverage is **based solely on the cost of employee-only coverage**. Under the ACA's pay-or-play rules, an ALE's health coverage is considered affordable for full-time employees and their family members if the employee portion of the premium for the lowest-cost self-only coverage that provides minimum value does not exceed 9.5% of an employee's W-2 wages, rate-of-pay or the FPL for a single individual. The employee portion of the premium for other coverage tiers (e.g., self-plus-one or family coverage) is not considered to determine affordability under the pay-or-play rules, regardless of the coverage tier selected by the employee.

Example: An ALE's health plan provides minimum value and has three coverage tiers: self-only, self-plus-one and family coverage. In 2026, employees must pay the following monthly premiums: $200 for self-only coverage, $300 for self-plus-one coverage and $400 for family coverage. An employee who has an hourly rate of pay of $20 elects self-plus-one coverage for 2026. The ALE uses the rate-of-pay safe harbor to determine affordability. Using this safe harbor, the employee's coverage is considered affordable if their monthly contribution for self-only coverage does not exceed approximately $259. Here is the formula: ($20 x 130 hours) x 9.96% affordability = $259. In this example, the ALE's health coverage is considered affordable because the $200 monthly cost for self-only coverage is less than $259.

Note that the affordability rules are different for determining whether an individual is eligible for the ACA's premium tax credit (PTC). The PTC lowers monthly premiums for eligible individuals who purchase health insurance coverage through an ACA Exchange. Individuals are ineligible for the PTC if they have access to affordable employer-sponsored health coverage. Under the PTC rules, the affordability of employer-sponsored health coverage for family members is determined based on the employee's share of the cost of covering the employee and those family members, not the cost of covering only the employee. However, the PTC's rules do not affect whether health coverage is considered affordable under the pay-or-play rules, which just consider the cost of employee-only coverage.

3. Mistake: Applying the Affordability Test to Every Health Plan Option Offered by the ALE

An employer that offers more than one health coverage option to its full-time employees satisfies the ACA's affordability test if the **lowest-cost option that provides minimum value is affordable**. While some employers offer only a single health

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plan option, many employers offer multiple health plan options. When an ALE offers more than one health plan option to its full-time employees, only one of the options needs to satisfy the ACA's affordability threshold.

Example: An ALE offers the following three health plan options to its full-time employees (all providing minimum value):

- Option A has the lowest deductible and a monthly premium of $400 for employee-only coverage.
- Option B has the next lowest deductible and a monthly premium of $250 for employee-only coverage.
- Option C has the highest deductible and a monthly premium of $100 for employee-only coverage.

To avoid penalties under the ACA's pay-or-play rules, only one of these options is required to satisfy the ACA's affordability threshold. Thus, if Option C is considered affordable for the ALE's full-time employees, employee contributions for Options A and B can exceed the ACA's affordability percentage without triggering penalties.

However, the affordable option must actually be offered to full-time employees. If a full-time employee is not eligible for the affordable option (e.g., because they live outside the coverage area), the ALE would need to provide another affordable option for that employee to avoid potential penalties.

4. Mistake: Basing the Form W-2 Safe Harbor on Employee Salary (Not Taxable Compensation)

An ALE using the Form W-2 safe harbor retroactively determines the affordability of its health coverage by looking at each **employee's wages reported in Box 1 of Form W-2**. These wages include taxable wages, tips and other compensation paid to the employee for the year, minus any pretax benefit deductions. This safe harbor is the least predictable method for determining affordability because it is based on the actual amount of each employee's W-2 wages, which is not known until after the end of the year. Employees' wages can change during the year for various reasons that are not within the employer's control, such as an increase to pretax 401(k) contributions or an unpaid leave of absence.

Due to this uncertainty, the Form W-2 safe harbor works best for employees whose annual compensation can be predicted with accuracy before the start of the year. The other safe harbors, rate-of-pay and FPL provide more certainty and predictability than the Form W-2 safe harbor. However, if an ALE is comfortable with this risk, the Form W-2 safe harbor potentially allows it to maximize employee contributions toward the cost of health coverage based on actual compensation.

5. Mistake: Not Knowing When to Include Health Plan Opt-out Payments in Affordability Calculation

Some employers offer their eligible employees a taxable cash incentive to waive coverage under the employer's group health plan. These arrangements, commonly known as "opt-out payments" are often aimed at employees with working spouses who are eligible for group health coverage through another employer. The employer benefits by avoiding the cost of paying for its share of the premiums while the employee receives the extra cash.

The IRS has provided guidance on how medical opt-out payments impact the affordability calculation. According to this guidance, unless certain requirements are met, opt-out payments are treated as **increasing employee contributions** for health coverage, making an ALE's health coverage less affordable under the pay-or-play rules. For example, an employee whose required contribution for the lowest-cost, self-only health coverage is $200 per month, but who is eligible for a cash payment of $100 per month if coverage is waived, would be treated as having a required contribution of $300 per month when determining if the coverage is affordable. However, if the opt-out arrangement is a conditional "eligible opt-

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out arrangement," the payments are not added to the affordability calculation. An eligible opt-out arrangement is one where the opt-out payments are available only to employees who decline employer-sponsored coverage and provide reasonable evidence that they and their expected tax dependents have or will have minimum essential coverage other than individual market coverage during the year.

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