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What to do about health care coverage and excise taxes

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The Affordable Care Act (ACA) has led to debates about specific provisions and political wrangling, but relatively little has been written to show employers how to use their own numbers to determine whether it's cheaper to provide coverage or pay the ACA excise taxes for not doing so. This article uses examples, formulas and realistic figures to prepare you to plug in your own numbers to see how some of your company's current and future decisions could affect finances. It doesn't attempt to cover the effect of your decisions on employees or employee relations.

What you could pay

A careful financial analysis is wise because of the amount of money involved. For employers with 50 or more full-time plus full-time equivalent employees, there are two excise taxes, both nondeductible. (Employers with fewer than 50 employees are not subject to the taxes.) The first is imposed if 95% or more of full-time employees (defined as those working an average of 30 or more hours per week) aren't offered coverage. The total tax is calculated by multiplying $2,000 per year by the number of full-time employees minus the first 30 employees. Even for a small company with just 50 employees, the tax can add up, as the following table shows:

How the tax adds up

Full-time employees	Annual excise tax
50	$40,000
100	$140,000
250	$440,000
500	$940,000
1,000	$1.94 million
5,000	$9.94 million
10,000	$19.940 million

The second tax kicks in if coverage doesn't meet minimum value and affordability requirements. To figure that tax, you multiply $3,000 by the number of full-time employees who purchased their insurance on a federal or state exchange and received a premium tax credit, which is available to lower-income individuals.

As we'll discuss, employers are subject to only one of these two excise taxes at any given time.

Offering coverage versus providing it

The first step in our financial analysis is comparing the cost of paying the $2,000 excise tax with the cost of providing coverage. To illustrate this comparison, we use data from a Kaiser Family Foundation survey.

Cost comparison

Pay excise tax	Provide coverage
$2,000	$5,000 (single
	$12,000 (family)

Source: *The Kaiser Family Foundation and Health Research and Educational Trust Survey of Employer-Sponsored Health Benefits*, 2013

Obviously, providing coverage is more expensive than paying the excise tax. But there's a big difference between providing coverage and offering coverage. You don't pay the excise tax if you offer coverage, even if you pass along the entire cost to the employee. To meet the requirement, you need only to offer coverage to 95% or more of your full-time employees; it doesn't matter how much you charge them or if any of them accept the coverage.

Now that we've clarified the difference between providing coverage and offering coverage, here's the accurate way to compare the costs:

Cost comparison

Pay excise tax	Offer coverage
$2,000	$0 (other than administrative costs, which are probably considerably less than $2,000 per employee)

It is clearly less expensive to offer coverage than to pay the $2,000 excise tax. Of course, if you decide to cover part of your employees' premiums, you'll incur more cost. But you don't have to do so to avoid this tax. As a result, employers who currently offer coverage should continue to do so, and those who don't offer coverage should start.

Applying the 50-employee threshold

The employer mandate — the rules governing excise taxes related to health insurance coverage offered to employees by employers — applies only to employers with 50 or more full-time plus full-time equivalent employees. So, if you have fewer than 50 such employees, the rules don't apply to you.

The 50-employee threshold is determined on a calendar-year basis, regardless of whether the employer is on a fiscal year or calendar year basis or the timing of the health plan benefit year. Companies with just under or just over 50 employees should be especially vigilant about tracking the number.

You calculate the employee count by looking at the preceding calendar year. If you're figuring your status for 2015, for example, you would look at 2014 to see if you had 50 or more full-time plus full-time equivalent employees. The results will determine whether you're subject to the employer mandate in 2015.

It's important to count employees at all related employers, including employers in a parent-subsidiary relationship or brother-sister corporations. This requirement prevents companies from circumventing the rules by creating a group of small entities — each of which has fewer than 50 people. If entities are under common control, all their employees must be aggregated.

It's equally important to recognize that certain individuals aren't treated as employees, including:

- Sole proprietors
- Partners in a partnership
- 2% S corporation shareholders even if they're employees
- Real estate agents and direct sellers
- Leased employees who are not common-law employees

In addition, hours worked outside the United States don't count in determining full-time or full-time equivalent employee status, resulting in the exclusion of employees who work outside the United States.

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Key points to keep in mind

Missing the 95% coverage requirement — even narrowly — can be costly. Consider a company with 1,000 full-time employees that offers coverage to 949 employees, or 94.9%. Even though the 95% requirement was barely missed, the employer still owes an excise tax of $1.94 million (1,000 full-time employees minus the first 30, multiplied by $2,000). Compliance with this rule is all or nothing, so you'll need to be extremely careful to hit or exceed the mark.

Keep in mind that to avoid the tax, you have to offer coverage to employees and their children, but not spouses.

Employers that are part of a group of related employers will need to aggregate the number of employees in the whole group to determine whether there is a total of 50 or more full-time plus full-time equivalent employees, which makes the group subject to the tax. In calculating the 95% threshold, however, each related employer is viewed as being separate and can make independent choices about coverage. That's a plus, especially for related companies that operate very independently, and it means that one employer's mistakes won't affect the other employers.

You don't pay the $2,000 tax unless one or more employees go to a federal or state exchange to get coverage and have income that qualifies for the premium tax credit. The courts are ruling on lawsuits challenging whether individuals who obtain coverage through a federal exchange are entitled to the premium tax credit, but it will likely take some time to resolve the issue. Until then, it's best to assume for planning purposes that employees on a federal exchange can get the credit. It takes only one employee to trigger the entire tax. If you don't

How to calculate

To calculate the number of full-time and full-time equivalent employees, follow these six steps and enter all information on a spreadsheet that lists each month in the calendar year.

1. For each month, enter the number of employees who worked an average of 30 or more hours per week during the month.
2. For each month, identify all employees who worked fewer than 30 hours per week for the month, total the number of hours for all of these employees, and divide the total by 120. This converts the hours to a full-time equivalent number.
3. Add the totals from Step 1 and Step 2 (full-time and full-time equivalents) for each month.
4. Add monthly totals from Step 3 to get a grand total for the year.
5. Divide the grand total by 12 to get an average for the year.
6. Review the average number of full-time and full-time equivalents for the year. If that number is 50 or more, you are subject to the employer mandate.

Special rules apply if you employ seasonal workers. If after completing the calculations described above, you have 50 or more full-time plus full-time equivalent employees, you can avoid the employer mandate if you meet both of the following requirements:

- Your workforce exceeds 50 full-time plus full-time equivalent employees for 120 days or fewer during the calendar year.
- The employees in excess of 50 employed during the 120-day period were seasonal workers.

offer coverage, it seems very likely that at least one employee will go to an exchange for coverage. The income levels to qualify for the premium tax credit are higher than you might expect. So, unless you pay high wages to all employees, you should assume the tax will be triggered if you don't offer coverage to at least 95% of your full-time employees.

The rules covering the second, $3,000, excise tax require employers to offer a plan that meets both minimum value and affordable coverage standards. Again, the two excise taxes are mutually exclusive. So, if you don't offer coverage to at least 95% of full-time employees, you will pay the $2,000 tax, but you won't pay the $3,000 tax, even if you don't meet the requirements. If you do offer coverage to 95% or more of full-time employees, you won't pay the $2,000 tax, but you will be on the hook to pay the $3,000 tax if you don't meet the related requirements.

Figuring minimum value

The minimum value rule to avoid the $3,000 tax says a plan must cover 60% or more of the total health care costs, so that employees pay no more than 40% of those costs, including deductibles and copays (but excluding premiums paid by employees). Fortunately, employers don't have to calculate this for their employee population. The Department of Health and Human Services has created a calculator enabling employers to enter the parameters of their plan, such as deductibles and copays, and using a representative U.S. employee population. Based on our experience, employers will usually meet this requirement easily.

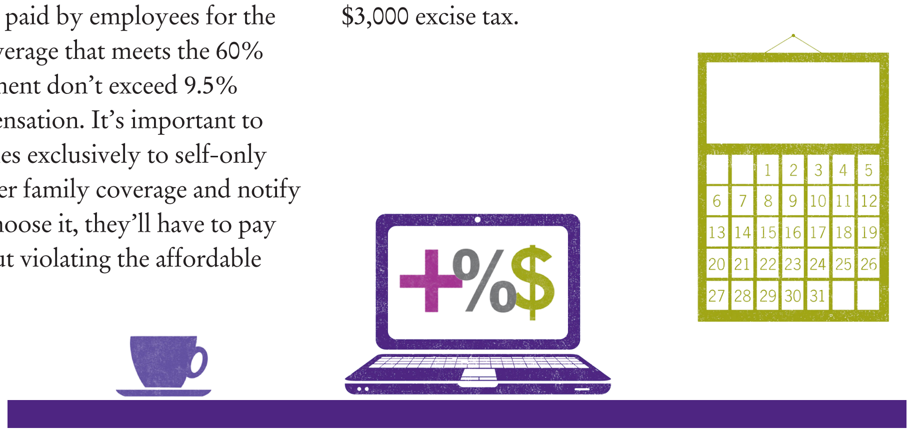
Figuring affordable coverage

Offering affordable coverage requires employers to make sure the premiums paid by employees for the lowest-cost self-only coverage that meets the 60% minimum value requirement don't exceed 9.5% of the employees' compensation. It's important to emphasize that this applies exclusively to self-only coverage. So you can offer family coverage and notify employees that if they choose it, they'll have to pay the full premium, without violating the affordable coverage requirement.

In figuring out whether you comply with this requirement, it's best to start by looking at the lowest amount you pay a full-time employee. That's because it will cost you more to offer affordable coverage to this employee than any other, since the cost you can pass on to the employee is limited to 9.5% of his or her income, and you have to pay the balance. This article uses $11,310 per year (30 hours per week times 52 weeks times the federal minimum wage of $7.25) as the lowest possible amount paid to a full-time employee. For coverage to meet the affordability requirement, you could charge this lowest-paid employee a premium of $89 a month ($11,310 times 9.5% divided by 12 months). If your state minimum wage exceeds the federal level, you'll need to use state numbers.

According to Kaiser Family Foundation data from 2013, employers are paying an average of $417 a month toward self-only coverage for each employee, and employees are paying an average of $83 a month. So the average employee is already paying less than the $89 minimum-wage–based amount for the lowest-paid person to have affordable coverage. That means the average employer is currently offering affordable coverage and won't have to make any adjustments to avoid the $3,000 tax.

For employers who are already offering affordable coverage, that's the end of the analysis. But if your coverage doesn't meet the affordability requirement — meaning the employee self-only premium exceeds 9.5% of compensation for some full-time employees — you'll need to figure out if it's less expensive to increase your employer premium payment to make the coverage affordable for the employees or pay the $3,000 excise tax.



Employers who aren't currently offering any coverage to some or all of their full-time employees will also need to do more analysis. We've already established that you should start offering coverage to avoid the $2,000 tax because you can pass on the full cost to employees. Next, you'll want to consider whether it makes sense to pay something toward coverage to make it affordable for employees and avoid the $3,000 tax.

A key point is that the $3,000 tax is paid only for employees who meet both of these requirements:

- They go to a state or federal exchange to get their coverage.
- They qualify for the premium tax credit because of their lower income.

So it seems logical for employers to try to determine whether an employee will qualify for the premium tax credit. If the employee doesn't qualify, the employer doesn't need to provide the employee with affordable coverage, because the employer won't be subject to the $3,000 excise tax. If the employee does qualify, the employer would come out ahead financially to provide him or her with affordable coverage if it costs less than paying $3,000 to the IRS.

People who earn a fair amount of money can qualify for the premium tax credit, as the following table shows.

Premium tax credit qualification

Family size	Maximum household income to qualify*
1	$45,960
2	$62,040
3	$78,120
4	$94,200
5	$110,280
6	$126,360
7	$142,440
8	$158,520

* Amounts are 15% higher for Hawaii and 25% higher for Alaska.

Given these amounts, you may have a considerable number of employees who could qualify for the premium tax credit and thus trigger the tax. If you try to identify who would qualify, you face the fact that qualification is based on family size and household income. Household income is the combined income of the employee's family members who are required to fill out a tax return, including the employee, the spouse and any dependents. The problem is that you have no idea what the household income is, making it impossible to determine who qualifies for the credit. Thus, you can't figure out which employees would trigger the $3,000 tax.

At this point, you may be tempted to throw up your hands and quit the analysis. But if you want to make smart decisions about coverage, you should proceed without considering whether employees would qualify for the credit. Focus on the rule that says if you offer an employee self-only coverage that meets the minimum value requirement and the premium is affordable, you don't have to pay the $3,000 tax even if the employee qualifies for the premium tax credit. So, compare the cost of providing affordable coverage to the $3,000 tax. If it's cheaper to provide affordable coverage for an employee than to pay the $3,000 tax, it makes sense to provide affordable coverage. If you go to the expense of providing affordable coverage to avoid the $3,000 tax, it's possible the employee won't qualify for the premium tax credit because his or her household income exceeds the limit, and you'll have spent money on providing affordable coverage to an employee who wouldn't trigger the $3,000 tax. Unfortunately, there's really no way around that, since you don't know who will qualify for the credit.

Even though you'll need to use your own numbers to analyze affordability, the following example uses realistic numbers to demonstrate the process. First, figure the annual premium for self-only coverage. We'll use $6,000 per year, a rounded number based on the average premium data from the Kaiser Family Foundation study. Next, we'll figure the employee compensation level for which the employer can pass along the full cost and still know the coverage is affordable to the employee. To do that, divide $6,000 a year by 9.5% to get $63,158. That means you can charge any employee who makes at least $63,158 the full cost, and you've offered that individual affordable coverage and avoided triggering the $3,000 tax.

Next, look at which employee's affordable coverage will cost you the most. As stated earlier, this will be the lowest-paid full-time employee. Most employers would use the federal minimum wage of $11,310. Multiply $11,310 by 9.5% to get $1,074 a year, which represents the charge to the employee. So the employer would pay $4,926, the difference between the self-only annual premium of $6,000 and $1,074. Clearly, it would be cheaper for the employer to pay the excise tax of $3,000 for not offering affordable coverage. But we haven't factored in tax deductibility.

To do that, you would multiply $4,926 by your tax rate, since health premiums are tax deductible. For example, an employer with a 30% tax rate would pay an after-tax premium of $3,448 (70% of $4,926). The $3,000 excise tax is not deductible. So, the net cost to provide affordable coverage is $448 for the employee who will cost the employer the most ($3,448 minus $3,000). Many employers would choose to spend $3,448 on an employee rather than to pay $3,000 to the IRS. Of course, the difference would be even smaller for employers in a higher tax bracket and larger for those in a lower bracket.

You can even calculate a breakeven point. We'll use the 30% tax bracket to illustrate. Divide $3,000 by 70%, since 70% is the after-tax cost to the employer. The result is $4,285. If the employer pays $4,285 toward the cost of coverage, the after-tax cost is $3,000, which equals the excise tax. Using a total cost of $6,000 for self-only coverage, the employee pays $1,715. The coverage will be affordable for any employee with compensation of $18,053 or more ($1,715 divided by 9.5%). So, for any employee who makes more than $18,053, it will be cheaper for the employer to provide affordable coverage than to pay the excise tax. For lower-paid employees, it will cost the employer more to provide affordable coverage than to pay the excise tax, but the difference may be slight, as illustrated previously.

The following are three options for premium structures that will offer self-only coverage and avoid the $3,000 tax (using numbers from our analysis):

1. Charge all employees a uniform percentage of compensation. You could charge everyone 9.5%, for example, so that the coverage is affordable for all employees, and so that all employees whose compensation is $63,158 or more are paying the full cost. This approach is cost-effective since you are charging employees as much as possible while still avoiding the $3,000 tax.
2. Charge all employees a uniform dollar amount. We previously calculated that for your lowest-paid employee, you can't charge more than $89 if you want to avoid the $3,000 tax. So you could decide to charge everyone $89 or a lower dollar amount. This structure is easier to communicate and administer than a percentage of compensation.
3. Charge all employees a uniform percentage of compensation but cap the charge. You might charge a 9.5% premium but cap the premiums paid by the employees at, for example, $300 a month, and pay the balance. If you wish to contribute to the cost of coverage for all employees, you avoid passing the full cost to them.

Transition in 2015

As a transitional step, the rules governing the excise taxes are partially in effect in 2015. For the $2,000 tax, the IRS has divided employers into two groups:

- 50–99 employees — The $2,000 tax doesn't apply in 2015.
- 100 or more employees — The percentage of employees who must be offered coverage is lowered to 70% from 95%, so that the cushion is much larger. If you fall below the 70%, you get a break on the first 80 employees.

For both groups, you must offer coverage to at least 95% minus the first 30 employees for 2016 and beyond.

For the $3,000 tax, the transition rule is simple. If you're in the 50–99 category, you're not subject to the $3,000 tax in 2015. If you have 100 or more employees for 2015, the $3,000 tax applies in 2015. The $2,000 and $3,000 excise taxes will be adjusted for inflation starting in 2015.

Conclusion and likely outcomes

Employers who complete the analysis presented in this article are likely to offer coverage to avoid the $2,000 excise tax. It simply makes sense. Regarding the $3,000 tax, the average employer already offers minimum value and affordable coverage, and most employers will continue offering affordable coverage because doing so costs less than the tax, except for lower-income employees. Employers may opt to offer affordable coverage for lower-income employees, too, especially because the cost may be only slightly higher than the tax, and they would rather spend the money on employees than send it to the IRS. Following the steps in this article with your own numbers will help you better understand how your health care coverage decisions will affect your company's finances.

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