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COMPLIANCE UPDATE

IRS Issues Final Rules for Family Coverage Affordability Determination

October 2022

The IRS has issued [final regulations](#) that change the way employer-sponsored plan affordability is calculated when determining if a family is eligible for a premium tax credit (PTC) when purchasing individual health insurance through a public Exchange. In fixing what is commonly referred to as the “family glitch,” affordability for family members will be based on the employee’s cost to cover the entire family rather than the cost of employee-only coverage. The change will allow more spouses and dependents to qualify for PTCs applied toward the cost of individual health coverage purchased through a public Exchange.

Background

An individual is eligible for a PTC (or tax subsidy) to help pay the monthly premiums for individual coverage purchased on a public Exchange if all of the following are true:

- The individual is not eligible for Medicaid, CHIP or Medicare;
- The individual is not enrolled in other minimum essential coverage (MEC); and
- The individual is not eligible for employer-sponsored group health plan coverage that provides minimum value and is affordable.

Individuals who are offered (or eligible for) minimum value, affordable coverage under an employer-sponsored group health plan are not eligible for a PTC when purchasing individual health insurance through a public Exchange. In general, a plan provides “minimum value” if the actuarial value of the benefits provided is at least 60%. Coverage is considered “affordable” if the employee contribution for employee-only (single) coverage does not exceed a set percentage (9.12% in 2023) of the employee’s household income. Currently, if the employee-only coverage is affordable, the coverage is considered affordable for spouses and dependents as well, regardless of the required employee contribution amount for family coverage.

New Rule

Effective January 1, 2023, employer plan affordability for family members will be based on the required cost for the entire family to participate in the employer-sponsored plan. Affordability for the employee will still be based on the employee’s cost for single (employee-only) coverage.

Important note: Employer contributions to determine ACA affordability remain unchanged.

Depending on an employer’s contribution arrangement, this could create a situation where *family members* are eligible for the PTC purchasing individual coverage, while the *employee* remains ineligible based on the cost of single coverage.

Determining the Cost of Employer-Sponsored Coverage

To determine the cost of coverage for purposes of affordability for family members, the entire employee contribution for family coverage is considered. For example, if an employer charges employees \$150/month to participate in single employee-only coverage and \$600/month for the employee to enroll in family coverage, you would compare the \$600 to the employee's household income to determine affordability for the family member and compare \$150 to the employee's household income to determine affordability for the employee.

Minimum Value

To affect an individual's eligibility for a PTC, an employer-sponsored plan must also provide benefits that meet the definition of minimum value (MV). In addition to providing 60% or better actuarial value, previous guidance indicated that plan benefits must also include substantial coverage of inpatient hospital services and physician services. This was previously set forth in proposed rules by the IRS, but not finalized. The IRS has formalized this requirement in the final rules.

Who Could Qualify for Subsidized Exchange Coverage?

The regulation provides several examples of who could now qualify for a premium tax credit based on the new formula for assessing affordability of employer-sponsored coverage. The examples cover multiple complex situations, and we have summarized the most relevant scenarios in the following chart:

Scenario 1: Carrie is married to John, and they file a joint tax return. John does not have access to employer-sponsored coverage, but Carrie does. Carrie's employer offers them coverage as a couple that is unaffordable based on their household income. However, the coverage would be affordable for Carrie if she joined the plan as a single individual.		
Who Has Affordable Coverage?	Who Qualifies for Subsidized Individual Coverage?	Does the Employer Have Penalty Liability?
<i>Carrie</i> has an offer of affordable employer coverage.	<i>John</i> qualifies for subsidized coverage because he does not have an affordable offer from either his or <i>Carrie's</i> employer.	<i>Carrie's</i> employer does not. If <i>John's</i> employer is an ALE, then they are at risk of receiving a penalty for not offering him affordable employee-only coverage.
Scenario 2: The facts of Scenario 1 remain the same, except that John gets a job at a company that offers him affordable coverage based on the single premium rate.		
Who Has Affordable Coverage?	Who Qualifies for Subsidized Individual Coverage?	Does the Employer Have Penalty Liability?
<i>Carrie</i> and <i>John</i> now both have affordable employer offers of employee-only coverage.	Nobody	No

Scenario 3: The facts of Scenario 2 remain the same; however, John and Carrie now have three children ages 10, 12, and 14. The cost to insure their whole family together under either employer plan would be unaffordable based on their family income.

Who Has Affordable Coverage?	Who Qualifies for Subsidized Individual Coverage?	Does the Employer Have Penalty Liability?
<p><i>Carrie and John</i> both have affordable employer offers of employee-only coverage.</p>	<p>Their <i>three children</i> qualify for subsidized coverage because they do not have affordable employer-sponsored coverage.</p>	<p>No</p>

Scenario 4: The facts of Scenario 3 remain the same, but Carrie's company instead offers affordable family-level coverage.

Who Has Affordable Coverage?	Who Qualifies for Subsidized Individual Coverage?	Does the Employer Have Penalty Liability?
<p><i>The whole family</i> now has access to affordable coverage through Carrie's employer. <i>John</i> continues to also have an offer of affordable employee-only coverage through his own employer.</p>	<p>Nobody</p>	<p>No</p>

Scenario 5: The facts of Scenario 4 remain the same, except John and Carrie no longer claim their oldest child, Catherine, as their tax dependent because she is now 23 and working. The cost of employer coverage through John's work remains unaffordable to anyone in the family except for him. The cost to insure John and the two younger children on Carrie's employer-sponsored plan is affordable. When they add in the cost of insuring Catherine, though, the coverage becomes unaffordable.

Who Has Affordable Coverage?	Who Qualifies for Subsidized Individual Coverage?	Does the Employer Have Penalty Liability?
<p><i>John, Carrie, and the two younger children</i> continue to have access to affordable coverage through Carrie's work. <i>John</i> continues to also have an offer of affordable employee-only coverage through his own employer. The fact that adding Catherine to Carrie's coverage would make it unaffordable for the whole family is not a consideration, as Catherine is not a tax dependent.</p>	<p><i>Catherine</i> may be eligible for subsidized coverage if she chooses not to enroll in Carrie's coverage. If she has an offer of affordable single coverage through her own employer, then she will not qualify for subsidized coverage.</p>	<p>Carrie and John's employers do not. If <i>Catherine's</i> employer is an ALE, then they are at risk of receiving a penalty for not offering her affordable coverage.</p>

Employee Election Changes

If an employer's open enrollment period aligns with the annual exchange open enrollment period, then it will be simple for qualified individuals to decline group coverage and enroll in subsidized individual coverage through an exchange. However, for employer benefits provided through a Section 125 cafeteria plan, employees are generally not allowed to make changes to their elections midyear unless they experience an allowable election change event as defined by the Section 125 rules.

To address situations where an employee may want to drop family coverage on the employer-sponsored plan so that the family can purchase subsidized individual health insurance, the IRS has also issued [notice 2022-41](#) which creates a new election change event for non-calendar year plans under Section 125 rules.

According to this new Section 125 rule, a non-calendar year cafeteria plan may allow an employee to prospectively revoke an election of family coverage under a group health plan provided the following conditions are satisfied:

- (1) A "related individual is eligible for a special enrollment period to enroll in a qualified health plan (QHP) through an Exchange, or an already-covered related individual seeks to enroll in a QHP during the Exchange's annual open enrollment period; and
- (2) The revocation of the election of coverage under the group health plan corresponds to the intended enrollment of the related individual or related individuals in a QHP through an Exchange for new coverage that is effective beginning no later than the day immediately following the last day of the original employer coverage that is revoked.

Employers can rely on an employee's attestation as proof that their relative has enrolled or will enroll in exchange-based coverage. Employers are not required to allow these election changes. However, if they wish to permit the changes, they must:

1. Inform employees of their right to make a change in accordance with the new rule, and
2. Adopt a formal plan amendment on or before the last day of the plan year in which the election changes are allowed. This amendment may be made retroactively to the first day of the plan year —meaning that election changes can technically be permitted before an amendment to the Cafeteria Plan document is made. Plans cannot be amended to allow an actual election of coverage to be revoked on a retroactive basis.

Employer Considerations

This change in affordability determination raises several important issues for employers.

- **No employer penalties for unaffordable family coverage** - Applicable large employers (those with at least 50 FTEs) can be liable for penalties under section §4980H if the employer plan is unaffordable for full-time employees. This rule remains unchanged, and employer penalties are based only on the cost of single or employee-only coverage. Employers are not required to provide affordable family coverage and will not be penalized in cases where family members receive the PTC when purchasing individual health insurance.
- **No change to employer reporting requirements** – Form 1094 and 1095 reporting requirements are not changed in any way. It remains unclear how the IRS and the health insurance exchanges will verify the cost of employer-sponsored dependent coverage or if an employee has an affordable offer of employer-sponsored coverage based on their family income.
- **No specific employee notice or disclosure requirements** - The rules do not impose any new employee disclosure or notice requirements. However, language in the "Exchange Notice" that employers provide to all new hires will need to be updated. Some employers may want to voluntarily communicate these changes to employees to help them understand their options regarding the employee's family's participation in the employer-sponsored plan versus purchasing subsidized individual coverage.

Summary

Note that the [Inflation Reduction Act](#) extended increased PTCs available when purchasing individual coverage to the public Exchange through 2025.

The combination of the increased subsidies with the ability for family (tax-dependent) members to qualify based on the family cost of the employer plan means that, depending on employer contribution policies and an employee's household income, a significant number of employees may find that family coverage is more affordable through a public Exchange than what is currently offered under their employer's plan.

The new rules are going into effect just in time for the open enrollment period that starts November 1 for Healthcare.gov/federal Exchange-based coverage (state-based Exchanges may have different annual open enrollment periods).

This means that employees may want to reconsider elections that they are currently in the process of making for employer-based calendar year plans. Employers will need to understand how this may affect some employees' enrollment decisions.

It is also likely that this change will face legal challenges. Amwins Connect will continue to monitor the situation to see if courts intervene in a way that could change the effective date of the change. Reach out to your Amwins Connect team with any questions.

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