



THE FIVE W's AND ONE H

Affordable Care Act (ACA) Affordability Safe Harbors

Who needs to worry about affordability safe harbors?

- All applicable large employers (ALEs), including employers that are nonprofits and government employers such as school districts and municipalities, must offer minimum value (MV), affordable coverage to their full-time employees to avoid a penalty, also known as an **employer shared responsibility payment**.
- Non-ALEs (employers who averaged less than 50 FTEs in the prior year) are not subject to the employer shared responsibility regulations, including affordability calculations.

Who is a full-time employee?

- A full-time employee is defined as someone who, for a calendar month, was employed on average at least 30 hours of service per week or 130 hours of service per month. An employer must use one of the two required tracking methods to determine this status: the monthly method or the measurement and lookback method.
- Coverage does not have to be affordable for part-time employees who average less than 30 hours of service a week or 130 hours of service per month.

Applicable Large Employer (ALE)

ALE as defined in section 4980H(c)(2) of the Internal Revenue Code, enacted by the Affordable Care Act (ACA), with respect to a calendar year, is an employer that employed an average of at least 50 full-time employees on business days during the preceding calendar year.

IRC §4980H(b)

The “B” Penalty

This is also referred to as the “tack hammer” penalty.

Full-time employees who were offered but declined employer coverage that did not provide minimum value or was not affordable will trigger the “B” penalty.

The monthly penalty assessed on an ALE for each full-time employee who receives a subsidy will be 1/12 (\$472.50) of \$5,670 per year (in 2027) for any applicable month.

What is the definition of affordability?

- Employer-provided coverage is considered affordable for an employee if the employee’s required premiums for the lowest-cost, self-only ACA-compliant coverage does not exceed 9.5% (as adjusted for inflation) of that employee’s household income. For 2027 this percentage is 10.22%, in 2026 it was 9.96%. An employer’s affordability is based on the lowest-cost, employee-only coverage that is offered to that employee — a lower-cost plan that is unavailable to that employee cannot be used for the calculation.

What is the purpose of an affordability safe harbor?

- ALEs are not likely to know the household income of their employees, so the IRS provides three safe harbors to determine affordability for purposes of the ACA: Form W-2 wages, an employee’s rate of pay or the federal poverty line (FPL)¹ which employers may use instead of household income in making the affordability determination.

Where is the affordability safe harbor used?

- Under the ACA, ALEs are required to report, typically using IRS Forms 1094C/1095-C, whether they did or did not offer minimal value, affordable coverage to each full-time employee (and dependents) for one or more months during the calendar year.
- For a full-time employee who was offered minimal value, affordable coverage but declined, an employer on Form 1095-C, Part II, Line 16, will report to the IRS the reason, (i.e. how affordability was determined) why it should not be subject to an employer shared responsibility penalty with respect to the employee on whom it’s reporting using the applicable safe harbor code for each calendar month.

¹ FPL is also commonly referred to as the federal poverty level safe harbor. However, in the final [IRS regulations](#) and [IRS Q&A 39 on employer shared responsibility provisions](#), the safe harbor is referred to as the federal poverty line safe harbor.

Why does it matter if an ALE offers affordable coverage?

- Under the ACA, an employee is not eligible for subsidized Marketplace/exchange coverage for any month in which the employee is offered health coverage under an eligible employer-sponsored plan that provides MV and that is affordable relative to the employee's household income.
- If an employer offers MV coverage to at least 95% of its full-time employees in any given calendar month but that coverage is not affordable under one of the safe harbors and a full-time employee is approved for a premium tax credit for Marketplace/exchange coverage, the employer may be subject to an employer shared responsibility payment, IRC §4980H(b)—The "B" Penalty.

When does coverage have to be affordable, and when is it reported?

- Affordability is calculated on a monthly basis (although most employers set stable annual premiums). Therefore, if coverage is affordable in some months of the year but not others, the employer only has a penalty risk for the months that coverage was not affordable.
- ACA reporting, which includes affordability, is done on IRS Forms 1094C/1095-C, which are due February 28 if filing on paper (or March 31 if filing electronically) of the year following the calendar year to which the return relates. Forms are due to employees on March 2 (or the next business day if March 2 is a holiday).

How are the safe harbors calculated?

- An ALE may choose to use one safe harbor for all of its employees or to use different safe harbors for employees in different categories, provided that the categories used are reasonable and that the employer uses one safe harbor on a uniform and consistent basis for all employees in a particular category. The final regulations clarify that reasonable categories generally include specified job categories, nature of compensation (for example, salaried or hourly), geographic location and similar bona fide business criteria.
- If an ALE offers multiple healthcare coverage options, the affordability test for a particular employee applies to the lowest-cost, self-only coverage option that provides minimum value and that is available to that employee.

Affordability safe harbors

Affordability safe harbors are used to determine whether the employer may be subject to an ACA shared responsibility penalty.

It is possible for the employer's coverage to be considered affordable under one of the three safe harbors (and therefore not liable for an ACA penalty) but unaffordable relative to the employee's household income, and the employee is still eligible for a Marketplace/exchange subsidy.

Form W-2 Wages Safe Harbor

- Generally requires an employer to look at each employee's wages at the end of the calendar year as reported on the employee's Form W-2 in Box 1.
- Coverage is affordable if the employee's required premiums for the lowest-cost self-only ACA-compliant coverage does not exceed 9.5% (indexed) of the employee's W-2 wages (as reported in Box 1).
- This requires a retrospective analysis, and an employer may not know if they passed until it's too late.
- A risky safe harbor to use, especially with an employee population whose schedules and incomes fluctuate.
- Employees with higher levels of pre-tax contributions (401(k), HSA, etc.) or who take unpaid leaves of absence can have their W-2 income decreased, and employers have no control over those factors.

Rate of Pay Safe Harbor

- Generally based on the employee's rate of pay at the beginning of the coverage period, with adjustments permitted, if the rate of pay is decreased (but not if the rate of pay is increased).
- Provides employers with a method for satisfying affordability prospectively without having to analyze each employee's wages and hours.
- Avoids the retrospective analysis required under the Form W-2 wages safe harbor and allows an employer to assume 130 hours/per month with some limitations (more below).
- A beneficial safe harbor to use for employees whose work hours fluctuate.

HOURLY EMPLOYEES

- Coverage is affordable for a calendar month if the employee's required premiums for the lowest-cost self-only ACA-compliant coverage does not exceed 9.5% (as adjusted) of an amount equal to 130 hours multiplied by the lower of the employee's hourly rate of pay as of the first day of the coverage period (generally the first day of the plan year) or the employee's lowest hourly rate of pay during the calendar month.
- 130 hours does not equal 40 hours a week and disregards overtime, extra shifts or schedule fluctuations.
- If an hourly employee's hourly rate of pay is reduced during the year, the rate of pay is applied separately to each calendar month, rather than to the entire year, and the employee's required contribution may be treated as affordable if it is affordable based on the lowest rate of pay for the calendar month multiplied by 130 hours.
- The affordability calculation is not altered by a leave of absence or reduction in hours worked.

- Example: If a full-time hourly employee earns \$10 per hour in a calendar month (and earned at least \$10 per hour as of the first day of the coverage period) but has one or more calendar months in which the employee has a significant amount of unpaid leave or otherwise reduced hours, the employer may still require the employee's contribution of up to 10.22% (in 2027) of \$10 multiplied by 130 hours (\$132.86).

NON-HOURLY EMPLOYEES

- Coverage to a non-hourly employee is treated as affordable for a calendar month if the employee's required premiums for the lowest-cost self-only ACA-compliant coverage contribution for the calendar month does not exceed 9.5% (as adjusted) of the employee's monthly salary, as of the first day of the coverage period (instead of 130 multiplied by the hourly rate of pay).
- If the monthly salary is reduced, including due to a reduction in work hours, the rate of pay safe harbor is not available.

TIPPED EMPLOYEES OR COMMISSION ONLY

- The rate of pay safe harbor cannot be used, as a practical matter, for tipped employees or for employees who are compensated solely on the basis of commissions. Employers can use the two other affordability safe harbors, Form W-2 wages and federal poverty line, for determining affordability for employees whose compensation is not based on rate of pay.

Federal Poverty Line Safe Harbor

- Intended to provide employers a predetermined maximum amount of employee contribution that, in all cases, will result in the coverage being deemed affordable.
- Only one calculation is required, and the result doesn't change if an employee's hours or pre-tax deductions change.
- Coverage is treated as affordable if the employee's required monthly contribution for the lowest-cost self-only ACA-compliant coverage does not exceed the federal poverty level for a single individual. (Calculated as 9.5% (as adjusted) of the most recently published poverty guidelines in effect within 6 months before the start of the plan year, divided by 12.)

FPL SAFE HARBOR FOR CALENDAR YEAR PLANS

	CALENDAR YEAR	AFFORDABILITY SAFE HARBOR	FPL SAFE HARBOR
Contiguous 48 States and DC	2027	10.22%	\$135.93
Alaska	2027	10.22%	\$169.91
Hawaii	2027	10.22%	\$156.37



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*STATISTICS ACCURATE AS OF MARCH 31, 2026.

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