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Federal Relations Advisory

# Fixing the 'family glitch': What does it mean for employers?

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# What is the ‘family glitch’?

The family glitch stems from a provision of IRS regulations that base Affordable Care Act premium tax credit eligibility on whether an individual has access to affordable employer-sponsored health care.

In general, employer-sponsored health coverage is considered affordable if the employee’s required premium is no more than a certain percentage of household income, with the percentage adjusted annually to reflect changes in health care premiums.

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| 2022 | **9.61%** |
| 2023 | **9.12%** |

**The new rule does not impact employer shared responsibility penalties or health coverage reporting requirements.**

However, the regulations did not consider the cost of coverage for the employee’s spouse and dependents, so a family could be disqualified for ACA-subsidized health insurance even though the employer-sponsored family plan was unaffordable.

The family glitch often occurred under a common plan design where employers paid a larger portion of plan cost for employees than for spouses or dependents.

## How do the new regulations fix the family glitch?

The new rule bases affordability on the cost of employer-sponsored coverage for families. As a result, spouses and dependents may be eligible for premium tax subsidies if the employer-sponsored family coverage is unaffordable. The new rule took effect Jan. 1, 2023.

# Does the new rule change the ACA employer shared responsibility penalties?

No. The ACA employer penalties are only triggered if an employee receives a premium tax credit. The new rule does not change the affordability standards for employees, only for spouses and dependents. Thus, the new rule will not impact employer penalties.

The ACA employer shared responsibility penalties (often called the employer mandate or employer pay-or-play penalties) are imposed under Internal Revenue Code section 4980H. The penalties apply only to Applicable Large Employers (ALEs). For an employer to be considered an ALE, it must have employed an average of at least 50 full-time employees (and full-time equivalent employees) during the prior calendar year.

## There are two separate penalties for ALEs.

The first is the largest and is often called the “A” penalty or the “sledgehammer penalty.” The second is less substantial and is often called the “B” penalty or the “tack hammer” penalty.

The **sledgehammer penalty** applies when:

1. The ALE does not offer minimum essential coverage that provides minimum value to at least 95% of its full-time employees (and their dependents).
2. At least one full-time employee receives a premium tax credit for health coverage purchased through an ACA exchange.

This annual penalty is equal to a specified dollar amount, multiplied by the number of full-time employees (with the first 30 employees subtracted). The calculation is based on the total number of full-time employees, including those covered by the employer’s health plan.

The specified dollar amount is indexed for inflation and began at $2,000 in calendar year 2014. In 2022, the dollar amount was $2,750; in 2023, the dollar amount is $2,880. Because the fine can be substantial, ALEs generally structure their health plans to avoid the sledgehammer penalty.

The **tack hammer penalty** is based only on the number of full-time employees who receive a premium tax credit, which could occur if:

1. The employee was not offered minimum essential coverage.

2. The employee was offered minimum essential coverage, but the coverage was not affordable to the employee or did not provide minimum value.

This penalty may be triggered even if the employer is not subject to the sledgehammer penalty. The penalty is equal to a specified dollar amount, multiplied by the number of full-time employees who received a premium tax credit.

The specified dollar amount is indexed for inflation and began at $3,000 in calendar year 2014. In 2022, the dollar amount was $4,120; in 2023, the dollar amount is $4,320.

In both cases, a penalty is triggered only if a full-time employee receives a premium tax credit. Because the new rule does not change premium tax credit eligibility for employees, there is no change in how the employer penalty applies.

The new rule also does not change employer reporting requirements, including reporting on IRS Form 1095-B (Health Coverage) and Form 1095-C (Employer-Provided Health Insurance Offer and Coverage).


## Can employers permit midyear cafeteria plan elections to allow individuals newly eligible for premium tax subsidies to drop their employer coverage (and thereby become eligible for a premium tax credit)?

Yes, the IRS issued guidance in Notice 2022-41 that permits (but does not require) employers to allow family members to prospectively drop the employer coverage, thus allowing them to be eligible for premium tax credits. This election applies to both calendar year and non-calendar year plans.

Such an election is permitted if:

1. The family member is eligible to enroll in a qualified health plan on an ACA exchange in either a special or open enrollment period.
2. The dropping of coverage corresponds with the intended enrollment of the family member in exchange coverage.

To make this option available, employers must amend the cafeteria plan to provide the election and notify participants of the amendment.

The amendment:

1. Must be adopted on or before the last day of the plan year in which the elections are allowed.
2. May be retroactive to the first day of that plan year, provided the cafeteria plan operates in accordance with Notice 2022-41.

An employer may amend a cafeteria plan to adopt the new permitted election changes for a plan year that begins in 2023 at any time on or before the last day of the plan year that begins in 2024. However, an employer may NOT amend a cafeteria plan to allow an election to revoke coverage on a retroactive basis.

It's important to note that while some family members will become newly eligible for exchange subsidies, dropping current employer-sponsored coverage and switching to exchange coverage might not be the best decision in all cases. Particular facts and circumstances should be considered, including premium costs, plan benefits, deductibles and out-of-pocket expenses.

# Conclusion

Employers should consult with their advisors on specific impacts related to their circumstances. In general, however, employers may offer limited midyear cafeteria plan election changes to allow family members to elect exchange coverage. In addition, the new rule does not impact employer shared responsibility penalties or health coverage reporting requirements.



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