



December 13, 2011

Submitted Electronically: Notice.comments@irsconsel.treas.gov

CC: PA: LPD: PR (Notice 2011-73)
Room 5203, Internal Revenue Service
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20044

Re: Notice 2011-73; Request for Comments on Health Coverage Affordability Safe Harbor for Employers (Section 4980H)

To Whom It May Concern:

These comments are submitted to the Treasury Department (Treasury) and the Internal Revenue Service (IRS) on behalf of the Small Business Coalition for Affordable Healthcare (the Coalition), pursuant to Notice 2011-73, Request for Comments on Health Coverage Affordability Safe Harbor for Employers (Notice 4980H).

Representing more than 150 of the country's largest, oldest and most respected small business associations, the Coalition has spent more than a decade working to increase access to and affordability of private health insurance. The Coalition's membership is diverse and includes small business organizations in the agricultural, automotive, construction, food services, floral, lodging, manufacturing, wholesale, retail, rental, entertainment, and houseware communities. As part of the nation's leading small business coalition, our members actively participated in the healthcare debate and advocated for solutions that would promote choice, enhance competition for private insurance and increase the overall affordability of health insurance for our country's job creators: America's small businesses.

Overview

We applaud Treasury's recognition that there is no practical means by which an employer can know the household income of an employee, and Treasury's recognition that this practical barrier must be overcome for the Patient Protection and Affordable Care Act's (PPACA) system of premium tax credits to work on a rational basis. In the absence of a safe harbor for determining household income, the system that results in premium tax credits inevitably would suffer from two unnecessary flaws.

First, it would have a “built in” bias for over-subsidization by employers of participation in employer-sponsored plans. A built-in bias toward over-subsidization of participation in employer-sponsored plans poses a serious threat to the interests of employees, because it steers a higher proportion of their overall compensation away from cash and from other valuable employer-provided benefits, without taking employee preferences into account. A built-in bias toward over-subsidization of participation in employer-sponsored plans also creates avoidable shortfalls in federal revenues, since it results in a marginal decrease in taxable compensation to offset an equal increase in non-taxable compensation.

Perhaps most importantly, to the extent an employer over-subsidizes participation in an employer-sponsored plan, the employer’s plan gains a competitive advantage *vis-à-vis* Exchange-available products that is greater than PPACA contemplates. This effect could skew all the premises on which current models for the growth and stability of the Exchanges are currently based.¹ We are confident that Treasury does not want to create any unnecessary risk that consumers will steer away from the Exchanges, especially given the market-share issues Treasury anticipates the Exchanges will face simply because of behavioral patterns. *See, e.g.*, Group Health Plans and Health Insurance Coverage Relating to Status as a Grandfathered Health Plan Under the Patient Protection and Affordable Care Act; Interim Final Rule and Proposed Rule, Preamble, 75 FR 34548, which explains that individual enrollees will be resistant to change, whether due to simple inertia, procrastination, a lack of relevant information or because they want to avoid risk associated with switching new plans.

Second, without a safe harbor for determining household income, affordability will be determined on a retrospective basis that takes into account factors that well-intentioned, compliance-minded employers cannot know in advance. Thus, despite the best efforts of employers to make premiums for their plans affordable, determining household income without a safe harbor will result in unintentional errors in a number of cases. Perhaps these circumstances will be rare, but that does not mean they should be ignored. To the contrary, when these circumstances are rare and random, this aspect of PPACA might be vulnerable to criticism that it fails to be rational.

Thus, Treasury’s consideration of an affordability safe harbor is an important step in the vital task of coordinating one of the many interrelated provisions of PPACA with all the others. An even greater degree of coordination is necessary to accomplish the important ends Treasury already has identified. Two simple additions to what Treasury already contemplates would make significant improvements in furthering these goals. First, we recommend that the measure of an employee’s total compensation should include an employee’s elective deferral contributions and other elective pre-tax benefits. Second, we

¹ In his March 30, 2011 testimony before the U.S. House of Representatives Energy and Commerce Subcommittee on Health, Congressional Budget Office Director Douglas Elmendorf explained that the “projected increase of 34 million in the number of insured people in 2021 reflects a number of differences relative to circumstances in the absence of PPACA and the Reconciliation Act. Approximately 24 million people will purchase their own coverage through insurance exchanges, and Medicaid and the Children’s Health Insurance Program (CHIP) will have roughly 17 million additional enrollees.” <http://www.cbo.gov/ftpdocs/121xx/doc12119/03-30-healthcarelegislation.pdf>.

recommend that an option for a second safe harbor affordability calculation be adopted that allows for reliance on the prior year's IRS Form W-2s (W-2).

Add-Back of Elective Deferral Contributions and Other Elective Pre-Tax Benefits

The proposed safe harbor would permit the use of the amount in Box 1 on Form W-2 as a proxy for the household income of the employee. As explained in Notice 2011-73, household income is defined as modified adjusted gross income of the employee and any members of the employee's family who are required to file an income tax return, and therefore household income is unlikely to be less than the wages paid to the employee. Notice 2011-73 proposes that "Wages for this purpose would be the total amount of wages as defined in § 3401(a), which is the amount required to be reported in Box 1 of Form W-2, Wage and Tax Statement (W-2 wages)." However, Box 1 on Form W-2 systematically understates employee compensation. Box 1 reports only taxable income, and therefore excludes elective deferrals under Section 402(g)², the value of certain benefits elected under Section 125³, and qualified transportation fringe benefits under Section 132(f)⁴. These amounts should not be excluded under the safe harbor, for several reasons.

First, pre-tax elective contributions made by an employee during a year represent actual current cash outlays by the employer to precisely the same extent that cash wages do. Therefore, out of simple fairness, they should be counted for purposes of the safe harbor.

Second, by definition, elective deferrals result in a decrease of cash wages that are otherwise available to the employee. A safe harbor that excludes them is bound to be less accurate as a tool in measuring affordability than a safe harbor that includes them.

Third, if an employer gears the rate at which it subsidizes a given employee's participation in its group health plan to Box 1 income without the add-backs for elective deferrals, it will subsidize the participation of two otherwise identically situated employees at different rates based solely on whether or not each contributes to a Section 401(k) plan at the same rate. This disparity is not contemplated by PPACA. It is likely to strike employees as arbitrary and unfair. Perhaps of greater significance, it runs contrary to a basic rule established in Treasury's regulations under Section 401(k), which prohibits conditioning anything of value other than a matching contribution on an elective deferral under Section 402(g).

Fourth, by failing to include such outlays in the proxy measurement of household income, Treasury inadvertently will create a disincentive for employers to permit elective deferral contributions under a Section 401(k) plan. This effect would thwart an important federal policy encouraging retirement savings.

² Code Section 402(g)(1)(A).

³ Code Section 125(a).

⁴ Code Section 132(a)(5).

Safe Harbor Method Based on Prior Year's W-2 Amount

Because an employee's household income takes into account factors that an employer is unlikely to know, implementation of Treasury's proposed affordability safe harbor for employers could provide some measure of predictability and administrative relief. However, the safe harbor as currently proposed requires an employer to monitor affordability throughout the year in order to ensure compliance, which is highly inefficient and unduly burdensome on the employer. Greater predictability and administrative efficiency easily can be achieved by adding a provision to the current proposed safe harbor that allows the employer to rely on the employee's W-2 compensation from the prior calendar year.

Consider, for example, an employer that is attempting to determine appropriate employee contributions for coverage in a given Year X+1. As a practical matter, employee contributions for coverage in Year X+1 are set no later than the autumn of Year X. Notwithstanding this timing, the proposed safe harbor would determine the affordability of these rates based on compensation in Year X+1. It is highly inefficient and unduly burdensome for an employer to monitor affordability throughout Year X+1 after the rates are set. Moreover, if wages decline during Year X+1, and as a result an employer is required as a practical matter to lower the rate of employee contributions during the year in response to the decline in wages, the employees must be given an opportunity to enroll in the employer's coverage at the reduced cost. This creates an opportunity for employees to select against Exchange-available coverage when the opportunity presents itself.

In circumstances where an employee's wages might be lower in Year X+1 than they were in Year X, an employer may not be able to predict with sufficient accuracy during the course of the year whether its plan will meet the affordability standard. For example, retailers and others whose annual manpower needs are heavily dependent on the November to December holiday trade may find that they have been caught short if consumer spending during those months is significantly less in Year X+1 than in Year X for reasons that were not predicted late in Year X, when employee contributions were set. Such concerns are magnified for smaller employers because the smaller the employer, the more variability in its sales, revenue and profits from year to year.

Manpower needs, commissions, overtime, revenue and profits are largely functions of macroeconomic circumstances beyond the control of the employer. Entrepreneurs already absorb 100 percent of the effects on their profit and loss statements from these factors. The proposed safe harbor creates an undue burden for smaller employers by saddling them with 100 percent of an additional, newly created monetary risk of declining economic conditions in the form of the employer penalty if the employer set employee contributions in good faith reliance on the prior year's W-2 wages.

Thus, with respect to full-time employees earning between \$15,028 and \$43,560 per year, employers need a safe harbor based directly on the prior year's W-2 amount in at least the following circumstances:

1. When the employee's compensation is sensitive to commissions;
2. When the employee's annual compensation is sensitive to hours worked during one or more particular seasons; and
3. When the employee's compensation is sensitive to bonuses based on revenues, profits or related metrics.

Further, creating such a safe harbor based directly on the prior year's W-2 amount will work to the advantage of most employees, because, normally wages rise from year-to-year. Therefore, in the typical case, when an employer sets employee contributions equal to 9.5 percent of the prior year's W-2 Box 1 amount, more employees will receive small increments in pay to bring them within "affordability" than those who would receive that small amount if the employer used the current year's W-2 Box 1 amount.

Finally, creating a safe harbor based directly on the prior year's W-2 amount is not difficult and would minimize the administrative burden for employers. In the typical case, employer-sponsored group health coverage would be deemed affordable for an employee for a year if the employee's required contribution does not exceed 9.5 percent of the prior year's W-2 Box 1 amount. For an employee who did not work during the entire previous year, W-2 Box 1 income can be prorated using the number of days employed divided by 365.

Sincerely,

American Farm Bureau Federation
American Foundry Society
American Society of Association Executives
American Supply Association
Automotive Aftermarket Industry Association
National Association of Wholesaler-Distributors
National Club Association
National Federation of Independent Business
National Roofing Contractors Association
North American Die Casting Association
Petroleum Marketers Association of America
Small Business & Entrepreneurship Council
Specialty Equipment Market Association
U.S. Chamber of Commerce