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Pay or Play—Impact on Fringe Benefit Rules for Federal Contract Workers

The Affordable Care Act (ACA) requires applicable large employers (ALEs) to offer affordable, minimum value health coverage to their full-time employees or pay a penalty. This employer mandate is also known as the "employer shared responsibility" or "pay or play" rules. The Service Contract Act (SCA) and the Davis-Bacon Act and Related Acts (collectively, the DBRAs) generally require workers on certain federal service contracts to be paid prevailing wages and fringe benefits.

The ACA's employer shared responsibility rules, the SCA and the DBRAs are separate laws which contain different, independent rules. ALEs subject to the employer shared responsibility rules as well as the SCA and DBRAs must comply with each separate law.

This ACA Overview provides information on how these laws interact with each other, and how employers can ensure compliance with each.

LINKS AND RESOURCES

- DOL All Agency Memorandum 220 (AAM 220) and FAQs addressing how the ACA interacts with the SCA and DBRAs
- IRS final regulations and Q&As on the employer shared responsibility rules
- IRS Notice 2015-87 clarified certain aspects of the interaction between the ACA, SCA and DBRAs (Dec. 16, 2015)

HIGHLIGHTS

APPLICABLE LARGE EMPLOYERS

- Only ALEs are subject to the employer shared responsibility rules.
- **ALEs:** employers that employed, on average, at least 50 full-time and full-time equivalent employees in the prior calendar year.

ALES AND FRINGE BENEFIT RULES

The ACA does not alter the SCA and DBRA requirements. Thus, for example, an employer covered by the SCA/DBRAs and the ACA's pay or play rules must also follow the applicable SCA or DBRA regulations regarding:

- The extent to which the employer may credit the cost of the plan toward its prevailing wage or fringe benefit obligations;
- How the hourly cost is calculated;
- The frequency of contributions; and
- Other relevant requirements.

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OVERVIEW

The SCA and the DBRAs require federal contract workers to be paid prevailing wages and fringe benefits, which often may be cashed out. The ACA's employer shared responsibility rules require an ALE to either:

- Offer its full-time employees (and their dependents) affordable, minimum value health coverage; or, alternatively,
- Pay a tax penalty to the IRS if the ALE does not offer this coverage and at least one full-time employee receives a subsidy for coverage purchased through an Exchange.

On Dec. 16, 2015, the IRS issued Notice 15-87, which clarified certain aspects of the interaction between the ACA, SCA and DBRAs. According to this notice, the IRS continues to consider how the SCA, the DBRAs and the employer shared responsibility rules may be coordinated. On March 30, 2016, the DOL issued AAM 220 and FAQs to provide additional guidance on the ACA's interaction with the SCA and DBRAs.

INTERACTION BETWEEN THE ACA, SCA AND DBRAS

The ACA, SCA and DBRAs are separate, independent laws. Employers subject to the ACA and the SCA or DBRAs are required to comply with each. **The ACA does not alter the SCA and DBRA requirements**.

Thus, for example, an employer covered by the SCA or DBRAs that offers a health plan in compliance with the ACA's employer shared responsibility rules must also follow the applicable SCA or DBRA regulations regarding:

- The extent to which the employer may credit the cost of the plan toward its prevailing wage or fringe benefit obligations;
- How the hourly cost is calculated;
- The frequency of contributions; and
- Other relevant requirements.

Conversely, employers that fulfill their SCA or DBRA obligations by providing health coverage for their employees are independently subject to the ACA's employer shared responsibility rules, if they are ALEs.

Employers should be aware of the independent requirements of these and other applicable laws. **Compliance with one law or requirement does not necessarily constitute compliance with another.**

Employer Fringe Benefit Payments and Affordability

Under the employer shared responsibility rules, employer-sponsored coverage is considered affordable if the employee's required contribution for self-only coverage does not exceed 9.5 percent (as adjusted) of his or her household income. In Notice 15-87, the IRS addressed how employer fringe benefit payments (including flex credits or contributions) under the SCA or DBRAs are counted in determining

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the affordability of employer-sponsored coverage for purposes of the employer shared responsibility rules (and related Section 6056 reporting requirements).

Until further guidance is issued and applicable (at least through 2016 plan years), employer fringe benefit payments under the SCA or DBRAs that may be used to pay for coverage under an eligible employer-sponsored plan will be treated as **reducing the employee's required contribution**, but only to the extent it does not exceed the amount required under the SCA or DBRAs.

For purposes of the ACA's premium tax credit and the individual mandate, however, individual taxpayers are not required to take these amounts into account as reducing the employee's required contribution.

Example. Employer offers employees subject to the SCA or DBRAs coverage under a group health plan through a Section 125 cafeteria plan, which the employees may choose to accept or reject. Under the terms of the offer, an employee may elect to:

- Receive self-only coverage under the plan at no cost; or, alternatively,
- Decline coverage under the health plan and receive a taxable payment of $700 per month.

For the employee, $700 per month does not exceed the amount required to satisfy the fringe benefit requirements under the SCA or DBRAs.

Conclusion: Until further guidance is issued and applicable (at least through 2016 plan years), for purposes of the employer shared responsibility rules (and related Section 6056 reporting requirements), the required employee contribution for the group health plan for an employee who is subject to the SCA or DBRAs is $0. However, for purposes of the premium tax credit and the individual mandate, that employee's required contribution for the group health plan is $700 per month.

Crediting Health Coverage Offered Under the ACA toward SCA and DBRA Obligations

Generally, employers may not credit any benefits that they are already required to provide under federal, state or local law toward their SCA or DBRA obligations. Questions have arisen as to whether health coverage provided by an ALE would be considered a benefit required by law, and therefore would not be creditable toward the employer's obligations under the SCA or DBRAs.

AAM 220 clarified that employer-provided coverage offered under the employer shared responsibility rules are **not benefits required by law for purposes of the SCA and DBRAs**. Therefore, all employers (ALEs and non-ALEs) may continue to take SCA or DBRA credit for contributions to bona fide health plans, as they have done in the past.

According to AAM 220, the employer shared responsibility rules do not require ALEs to purchase or cover the cost health coverage for its employees. Instead, ALEs have a choice of either offering the required coverage or paying the penalty. As a result, AAM 220 concludes that health coverage offered by ALEs is not a benefit required by law. Therefore, the DOL will **allow ALEs to credit their contributions to bona fide health plans toward the satisfaction of SCA or DBRA fringe benefit obligations**.

Crediting Employer Shared Responsibility Penalties Toward SCA and DBRA Obligations

Although an ALE may choose to either offer the required coverage or potentially owe an employer shared responsibility penalty, AAM 220 states that **the amount of any employer shared responsibility penalty may not be credited toward SCA or DBRA obligations**.

The SCA and DBRAs do not define the term "fringe benefits" or provide exhaustive lists of these types of benefits. However, the DOL asserts that it is clear from the examples of benefits listed in the legislation and regulations—such as medical care, pensions, life insurance and health insurance—that a tax penalty does not qualify because, unlike these benefits, it does not confer benefits specifically on employees.

Moreover, under the SCA, fringe benefits must either be provided: (1) In cash; (2) Through a plan whose primary purpose is "to provide systematically for the payment of benefits to employees on account of death, disability, advanced age, retirement, illness, medical expenses, hospitalization, supplemental unemployment benefits and the like;" or (3) Under some circumstances, through an enforceable commitment by the employer to provide benefits to its employees. According to the DOL, a tax penalty meets none of these requirements.

Under the DBRAs, all covered workers must be paid in a combination of wages and/or bona fide fringe benefits (or cash equivalents thereof). The DOL has consistently held that fringe benefit contributions under the DBRAs generally must vest to the exclusive benefit of the employee whose work led to the contributions (that is, they must provide a direct, specific benefit to the employee in question). An employer shared responsibility penalty does not provide this type of direct, specific benefit.

Thus, the employer shared responsibility penalty cannot be credited toward SCA or DBRA requirements.

SCA or DBRA Fringe Benefit Requirements When Employees Decline Health Coverage

An employer covered by the SCA or DBRAs may choose the manner in which it satisfies its fringe benefit obligations, and is generally not required to provide employees with a choice of accepting or declining the benefits chosen by the employer. Because it is the responsibility of an employer to satisfy its fringe benefit obligations under the SCA or DBRAs, these laws allow the employer to choose the fringe benefits to be provided, whether or not the employees prefer the chosen benefits, different benefits or cash.

Similarly, under the ACA's employer shared responsibility rules, an ALE is not required to provide its employees with an opportunity to decline health coverage if the coverage the ALE offers provides minimum value and costs no more than 9.5 percent (as adjusted annually) of the federal poverty line (determined on a monthly basis). However, if the coverage does not provide minimum value or costs the employee more than the above amount, then an ALE is not treated as having made an offer of coverage unless **the employee has an effective opportunity to decline to enroll**.

Regardless of whether the employer is an ALE, if some employees decline (and the employer therefore does not purchase or cover the cost of health coverage for those employees), the employer must still

satisfy its SCA or DBRA obligations through some other means—either in cash or by providing some other bona fide fringe benefit. The DBRAs and SCA require that wages and fringe benefits be furnished to employees. Merely offering benefit, but ultimately not providing them, does not suffice.

If employees choose cash payments or benefits other than those chosen by the contractor, under the SCA and DBRAs, that would be a matter for discussion and resolution between the employees or their authorized representative and the employer. Notice 15-87 (discussed above) addresses the treatment of amounts that may be used either for employer-provided health coverage or for non-health benefits (or received in cash) in this context for purposes of the employer shared responsibility rules.

Does a "Bona Fide Fringe Benefit Plan" Qualify as an "Eligible Employer-sponsored Plan"?

As noted above, the ACA's employer shared responsibility rules, the SCA and the DBRAs are separate laws which contain different, independent rules. As a result, the fact that a health plan is a "bona fide" fringe benefit plan under the SCA and DBRAs does not guarantee that offering this type of plan will satisfy the ALE's employer shared responsibility requirements.

Under the SCA, a "bona fide" fringe benefit plan must have the following basic elements:

- It must be specified in writing and communicated in writing to employees;
- Contributions must be made pursuant to a plan, fund or program;
- Its primary purpose must be to systematically provide for benefits payments to employees;
- It must contain a definite formula for determining contributions and benefits; and
- Contributions must be made irrevocably to a trustee or third party with fiduciary responsibilities.

DBRA regulations do not list requirements of a bona fide plan, but indicate that:

- Benefits funded under a trust or insurance program would typically be bona fide; and
- The "bona fide" requirement excludes fringe benefits that are "illusory or not genuine."

Because these basic requirements will typically apply to any legitimate health plan, the DOL anticipates that eligible employer-sponsored plans, as defined under the ACA, will be bona fide under the SCA or DBRAs. However, SCA and DBRA employers who are **ALEs must separately determine whether their bona fide health plan is sufficient to avoid the employer shared responsibility penalties**, including whether the coverage is affordable and provides minimum value.

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