



**The Affordable Care Act
Impact on Service Contract Act Health & Welfare Benefits**

by

**Bicknell C. Robbins, Esq.
President and General Counsel
Government Contracting Practice
CBIZ Benefits and Insurance Services, Inc.**



As we enter 2013 with 2014 looming on the horizon, employers are paying more attention to Health Care Reform and those aspects of the law that will take effect in 2014. Of particular concern to many employers is the Affordable Care Act's shared responsibility requirement. The shared responsibility provision requires employers employing 50 or more employees to offer adequate coverage at an affordable rate, or risk becoming subject to an excise tax. While this provision of the law is a major concern to affected employers, it should be of particular concern to government contractors with employees covered under the Service Contract Act, especially those that have been complying with the benefit provisions of the Act by providing cash in lieu of benefits.

Employers who have contracts with the federal government that are subject to the Service Contract Act (SCA) must meet the wage and benefit provisions of the contract's Wage Determination (WD). The benefit, or "Health & Welfare", provision of the applicable wage determination specifies the minimum hourly cost of "bona fide" benefits the employer must provide to employees covered by the Act. In the case of a fixed cost wage determination, each SCA employee must be provided with a benefit package costing the employer at least the specified amount for each hour paid (up to 40 hours per week) or provide the employee a cash payment in lieu of benefits, or some combination of the two.

For example, if an employer is providing services under a contract with a Wage Determination that specifies a Health & Welfare requirement of \$3.71 per hour, the employer can meet that obligation by providing its employees with a benefit package costing the employer at least \$3.71 per hour (or \$643.07 per month), or pay the employee an additional "cash in lieu" of benefits payment of \$3.71 for each hour paid, or some combination of the two.

The "cash in lieu" option is intended to provide employers that don't typically offer benefits to employees a method of complying without having to go through the process of adopting employer sponsored benefit programs that are generally subject to ERISA. Alternatively, some employers view the administrative burden of tracking benefit costs on an hourly basis as impractical and view providing cash in lieu of benefits as the easiest method of complying.

As we've discussed in past articles, providing cash in lieu of benefits, while administratively simple, is perhaps the most costly method of meeting the Wage Determination's Health & Welfare (H&W) requirement. Paying the hourly H&W in cash converts what would otherwise be a tax free benefit to a taxable wage which is then not only taxable to the employee, but is subject to the employer's share of the 7.65% FICA tax. The employer is also likely to incur additional costs in the form of premiums that are cash wage driven, such as workers' comp and general liability premiums. This additional cost to the employer could be as high as 25% of the total amount paid to SCA employees as cash in lieu of the fringe benefit.



Beginning in 2014 employers who opt to pay cash in lieu of benefits may have this additional cost increased by the “shared responsibility” excise tax. This tax could be as much as \$2,000 times the number of full time employees over 30. This would be applied to the employer’s total employee population, not just the SCA employees receiving cash in lieu of benefits. For those SCA employers who will be subject to this potential excise tax, the additional cost it imposes on the “cash in lieu” method of compliance is prohibitive.

To illustrate the dramatic impact the shared responsibility provision will have on SCA employers providing cash in lieu of benefits, let’s look at the following example:¹

Acme Service Contractors, Inc. has 200 full time employees. 50 of these employees work in the corporate office or on non-government contracting projects. These 50 employees are offered medical insurance that meets the “adequate coverage at an affordable rate” requirements of the Affordable Care Act. The remaining 150 employees are employed on a government contract subject to the Service Contract Act. The Wage Determination for this contract specifies an hourly H&W requirement of \$3.71 per hour for all hours paid, up to 40 hours per week.

To meet its hourly H&W obligation under the contract, Acme provides each SCA employee working on the contract a payment of \$3.71 for each hour paid in addition to the employee’s regular hourly wage. This satisfies the employer’s H&W obligation under the Service Contract Act as set forth in the Wage Determination.

Employee A is a SCA employee working for Acme and has a household income that is less than 400% of the federal poverty level. Employee A purchases health insurance through a public exchange and receives federal assistance towards the payment of the premium.

Because Acme has more than 50 full-time employees but does not offer adequate coverage to at least 95% of these employees, it is subject to the adequate coverage excise tax. Due to the fact that at least one of its full time employees purchased through an exchange and received federal assistance, that tax will be assessed. The tax due will be calculated as 170 employees (200 minus 30) times \$2,000 or \$340,000.

Let’s now assume that Acme provides its SCA employees with cash in lieu of benefits equal to the required \$3.71 per hour but allows the SCA employees to then elect health coverage under the company’s medical plan. SCA employees who elect coverage agree to pay the full cost of the coverage through payroll deduction on a pre-tax basis under the company’s Section 125 Premium

¹ A detailed discussion on who is subject to the excise tax and under what circumstances is beyond the scope of this article. Readers are directed to the CBIZ Health Reform Bulletin issued on January 9, 2013 on Shared Responsibility Guidance available by clicking [here](#).



Conversion Plan. Under this example, Acme is providing adequate coverage to all employees. The question is whether the coverage is “affordable coverage”.

Coverage under an employer-sponsored plan is deemed affordable to a particular employee if the employee's required contribution for single coverage does not exceed 9.5% of the employee's household income for the taxable year. For this purpose, household income means the modified adjusted gross income of the employee and any members of the employee's family (which would include any spouse and dependents) who are required to file a federal income tax return.

If the offered coverage is deemed unaffordable and at least one employee purchases health insurance through an exchange and received federal assistance, the employer will be subject to an excise tax equal to the lesser of:

- Number of credit employees² multiplied by \$3,000 per year, or
- Number of full-time employees minus the first 30 multiplied by \$2,000 per year.

If Acme is paying cash in lieu of benefits, that makes those payments a taxable wage to the employee. In our opinion, if a SCA employee then elects employer provided coverage and pays for that coverage through a payroll deduction of his or her cash wage, including the cash wage representing the hourly H&W payment under the Wage Determination, 100% of the cost of that coverage is being paid for by the employee and that cost should be used to determine whether the coverage is affordable. With single coverage exceeding \$400 per month being a common occurrence, it's almost a certainty that an employer paying cash in lieu of benefits while still offering health coverage to employees under this scenario will be found to not offer “affordable care” and therefore be potentially liable for the excise tax.

Many employers have asked if the DOL is contemplating doing away with the cash in lieu option once the individual mandate and shared responsibility rules go into effect. In our conversations with the DOL they have indicated that there are currently no ongoing discussions to do away with cash in lieu as a method of compliance. Our sense is that the Wage and Hour division responsible for enforcing SCA compliance is focused strictly on those issues. If an allowable method of compliance then results in an excise tax, that's an enforcement issue of the Treasury Department and doesn't impact Wage and Hour's enforcement initiatives.

² A credit employee is one who works at least 30 hours per week and who is eligible for a premium tax credit or cost sharing assistance for buying insurance through an exchange



What Should a SCA Employer Do?

1. Determine whether the shared responsibility requirements apply to you (generally 50 or more full time employees).
2. Next, determine whether you are meeting your SCA H&W obligation under any contract by paying cash in lieu of bona fide benefits.
3. Assuming a worst case scenario (i.e. at least one SCA employee will purchase through an exchange and receive federal assistance) calculate your estimated potential excise penalty.

If you go through these steps and determine that you do have a potential excise tax liability, you should begin exploring options for offering essential affordable care to these SCA employees rather than paying cash in lieu of benefits. As we discussed in our article “Service Contract Act Health & Welfare Benefits: Contractor Obligations, Options and Best Practices” (available [here](#)), employers should be able to provide a base plan of medical coverage that meets the essential care requirements and that is paid for entirely through the employer’s hourly H&W obligation, thereby meeting the affordable care requirements. Such a practice eliminates the current additional cost of employment taxes and other related payroll expenses and avoids any future assessment of a potential excise tax due to a failure to offer such coverage.



The information contained herein is not intended to be legal, accounting, or other professional advice, nor are these comments directed to specific situations. The information contained herein is provided as general guidance and may be affected by changes in law or regulation.

The information contained herein is not intended to replace or substitute for accounting or other professional advice. Attorneys or tax advisors must be consulted for assistance in specific situations. This information is provided as-is, with no warranties of any kind. CBIZ shall not be liable for any damages whatsoever in connection with its use and assumes no obligation to inform the reader of any changes in laws or other factors that could affect the information contained herein.

As required by U.S. Treasury rules, we inform you that, unless expressly stated otherwise, any U.S. federal tax advice contained herein is not intended or written to be used, and cannot be used, by any person for the purpose of avoiding any penalties that may be imposed by the Internal Revenue Service.