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Opt-Out Payment Rules and Affordability under the ACA's Employer Mandate

Some employers offer their employees a cash incentive under their cafeteria plan to waive employer-provided medical coverage. The employer benefits under these arrangements, known as “opt-out payments” or “cash in lieu of benefits,” by avoiding the cost of paying for its share of the premiums, while the employee benefits by receiving extra cash. These opt-out payments are still permissible, but there are issues under the Affordable Care Act (ACA) that impact the design of these arrangements. Employers with opt-out payments should review their approach to confirm they meet the *eligible opt-out arrangement* exception from the ACA pay or play (employer shared responsibility mandate) affordability calculation.

The ACA pay or play “affordability” calculation

To avoid potential penalties under the pay or play shared responsibility rules, applicable large employers or “ALEs” must offer affordable, minimum value health coverage to substantially all full-time employees. In general, the affordability of an employer’s offer of health coverage depends on whether the employee’s required contribution for self-only coverage exceeds a certain percentage of the employee’s household income. The IRS previously issued guidance on opt-out payments and affordability in [Notice 2015-87](#). Recently issued [proposed regulations](#) also focus primarily on the effect of opt-out payments on the affordability of employer-sponsored coverage. Under this guidance, whether an opt-out payment will need to be counted toward affordability depends on whether the payment is made under a *conditional or an unconditional opt-out arrangement*.

Medical opt-out arrangements

Opt-out payments made under an *unconditional opt-out arrangement* will increase an employee’s required contribution when calculating affordability under the ACA’s employer shared responsibility mandate. Opt-out payments made under a *conditional “eligible” opt-out arrangement* are disregarded in determining the required contribution for affordability purposes.

An *unconditional medical opt-out payment* is an arrangement where the opt-out payments are conditioned solely on an employee declining coverage under an employer’s health plan and not on an employee providing proof of other coverage. The IRS will consider the opt-out payment as an additional charge to the employee (a required contribution) in calculating affordability because the employee has the option of receiving additional salary for declining coverage, and thus is being charged the amount of the additional salary by accepting coverage. According to Notice 2015-87, it is generally appropriate to treat *unconditional opt-out payments* as increasing an employee’s contribution for health coverage beyond the amount of the employee’s salary reduction

contribution. For example, if an employer offers employees group health coverage through a Section 125 cafeteria plan requiring employees who elect self-only coverage to contribute \$200 per month toward the cost of that coverage, and it offers an additional \$100 per month in taxable wages to each employee who declines the coverage, the employee would be treated as having a required contribution of \$300 per month when determining if the coverage is affordable. In this case, the employee contribution for the group health plan effectively would be \$300 (\$200 + \$100) per month, because an employee electing coverage under the health plan must forgo \$100 per month in compensation in addition to the \$200 per month in salary reduction.

A *conditional medical opt-out payment* is an arrangement where the opt-out payments are conditioned not only on the employee declining employer-sponsored coverage, but also on the employee's satisfaction of one or more meaningful conditions (such as the employee providing proof of enrollment in other coverage). According to the proposed regulations, these payments would increase an employee's salary reduction contribution when determining the health plan's affordability. But if the opt-out payment is conditional on the employee having alternate coverage, such as through a spouse's plan, the amounts can be disregarded in determining the required contribution if the arrangement is an *eligible opt-out arrangement*. Under an *eligible opt-out arrangement*, the opt-out payments are available only to employees who decline employer-sponsored coverage and provide reasonable evidence that they and their expected tax dependents have or will have minimum essential coverage (other than coverage in the individual market, whether or not obtained through the public Marketplace) during the period of coverage to which the opt-out arrangement applies. The evidence of alternative coverage must be provided at least once every plan year to which the *eligible opt-out arrangement* applies. For example, if an employee's expected tax family consists of the employee, the employee's spouse and two children, the employee would meet this requirement by providing reasonable evidence that the employee, the employee's spouse and the two children will have coverage under the group health plan of the spouse's employer for the period to which the opt-out arrangement applies.

Effective Date

The IRS is expected to issue final rules later this year and anticipates these requirements to be effective for plan years that begin on and after January 1, 2017. However, the IRS plans to apply these rules beginning December 16, 2015, for any opt-out arrangements that are adopted after December 16, 2015. For this purpose, an opt-out arrangement will be treated as adopted after December 16, 2015, unless:

- The employer offered the opt-out arrangement (or a substantially similar opt-out arrangement) with respect to health coverage provided for a plan year including December 16, 2015;
- A board, committee or similar body, or an authorized officer of the employer specifically adopted the opt-out arrangement before December 16, 2015; or
- The employer had provided written communications to employees on or before December 16, 2015, indicating that the opt-out arrangement would be offered to employees at some time in the future.

The proposed regulations clarify that this includes an *unconditional opt-out arrangement* that is required under the terms of a collective bargaining agreement (CBA) in effect before December 16, 2015. As a result, employers participating in a collective bargaining agreement (CBA) are not required to increase the amount of an employee's required contribution by amounts made available under the opt-out arrangement for purposes of the employer shared responsibility rules

or ACA reporting until the later of:

- The beginning of the first plan year that begins following the expiration of the CBA in effect before December 16, 2015 (disregarding any extensions on or after December 16, 2015); or
- The applicability date of these regulations with respect to the employer shared responsibility rules and ACA reporting.

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