The Impact of Opt-out incentives on ACA affordability calculations

The question had arisen on how to treat opt out incentives. By that we mean a monetary offer by an employer to employees to waive coverage under the employer's health plan. Informal IRS comments had indicated that such incentives would be included when determining whether an offer of coverage is affordable.

There are generally two kinds of opt outs – conditional and unconditional:

- Unconditional opt-out arrangement – an arrangement providing for a payment conditioned solely on an employee declining coverage under an employer's health plan
- Conditional opt-out arrangement – an arrangement providing for a payment after satisfying a meaningful requirement, such as proof of coverage by a spouse's employer.

Late last year, the IRS issued Notice 2015-87 which provided guidance in the form of questions and answers on certain group health plan provisions of the Affordable Care Act one of which generally related to unconditional opt-out incentives. This ALERT focuses on the Q&A relating to unconditional employer opt-out incentives.

Quick overview of affordability

Affordability is a key component of the shared responsibility requirements. An employer might find himself/herself subject to a penalty if an employee goes to the Marketplace (formerly known as an Exchange) and obtains a premium credit because the employer plan is not affordable or does not provide minimum value.

An employee is not eligible for a premium tax credit for any month in which the employee is offered employer sponsored coverage that is affordable and provides minimum value. Affordability is measured as 9.5% (9.56% for 2015 and 9.66% for 2016) or less of household income. For purposes of determining group health affordability, employers can look to the cost of self-only coverage compared to an employee's W-2 wages (other methods of calculating affordability are available).

It is not unusual for employers to offer incentives to encourage employees to waive coverage. Incentives can provide extra cash to employees, especially if the employee has other coverage available, e.g. a spouse's plan. Incentives can also lower plan costs.

Employers have wondered if such opt-out incentives impact affordability. Up until recently, there were only some unofficial IRS comments on this issue. Notice 2015-87 provides much needed guidance.

An opt-out payment may have the effect of increasing an employee's contribution for health coverage beyond the amount of any salary reduction contributions.

The example contained in the Q&As is the best way to explain the IRS's position:

An employer offers coverage through an IRC 125 plan costing $200 per month for employee coverage. The employer offers $100 per month to employees to decline coverage. The IRS believes that the offer of $100 in additional compensation has the economic effect of increasing the employee's contribution for the coverage effectively making the cost of coverage $300. The rationale is that an employee electing coverage is giving up $200 in compensation (the cost of the coverage) as well as the $100 incentive to decline.

Regulations will be forthcoming

The IRS intends to request comments and propose regulations on the treatment of employer opt-out incentives. The regulations will generally apply for periods after the issuance of the regulations. The IRS anticipates that the regulation will require inclusion of an unconditional opt-out incentive in the employee's contribution for opt-out arrangements adopted after December 16, 2015.

An opt-out arrangement will be treated as adopted before December 16, 2015 if:

1. The employer offered the opt-out arrangement (or a substantially similar opt-out arrangement) with respect to health coverage for a plan year including December 16, 2015;
2. A board committee, or similar body or an authorized officer of the employer specifically adopted the opt-out arrangement before December 16, 2015 or
3. 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.

Some key take-aways:

1. Until final regulations are issued, employers with opt-out arrangements in effect before December 16, 2015 do not have to reflect opt-out incentives in affordability calculations nor include on the 1095-C. It is expected that opt-out arrangements effective after December 16, 2015 will be required to be included in affordability calculations and on Form 1095-C.
2. Employees can include the opt-out incentive in the cost of coverage should they apply for a premium subsidy.
3. Proposed and final regulations are expected to address both conditional and un-conditional opt-out incentives.
4. Always remember to document your plan design decisions.
5. Communicate the plan clearly to participants.
6. If you offer an opt-out incentive, consider commenting to the IRS and stay tuned!

Note: all links are active as of the date of issuance of this ErisaALERT.