Do New IRS Rules Put Employers with Healthcare Opt-out Provisions at Risk?

Some employers have figured out that they can save money by paying employees to opt out of company healthcare. Instead of paying for healthcare premiums, they pay out cash.

But how does that affect the math and tax penalties behind the Affordable Care Act ("ACA")?

The new notice of proposed rulemaking ("NPRM") from the IRS is all about government healthcare math – specifically, **how do you calculate the premium tax credit** for taxpayers who are offered **cash to opt out of their employers' healthcare plans?**

This opt-out payment option might seem like it can keep employer costs down and give employees more choice, but it's producing just as many questions as answers right now.

The idea is that the employee will use that opt-out money to find his or her own coverage, either through the Health Insurance Exchanges ("Exchanges" or "Marketplace") or directly through insurance companies, while the employer saves money on the costs associated with offering and administering health insurance to that employee.

But these opt-out provisions beg a few questions:

- How do you calculate what that opt-out provision does to the numbers when figuring out if an employer's group health plan meets affordability standards under the ACA?
- Is an employer who offers a health insurance opt-out provision at greater risk of being hit with the employer mandate penalty under the ACA?
- If an individual gets extra cash from their employer to pay for health insurance, are they still eligible for a federal subsidy to help them pay for insurance premiums? If so, how much?

These are the questions the IRS has been considering about employer opt-out provisions in Notice 2015-87 and in this new NPRM. The IRS is expected to issue final rules later this year and anticipates the requirements to be effective for plan years that begin on and after January 1, 2017.

Background

Employers who are subject to the ACA employer mandate (i.e. employers with 50 or more full-time and full-time equivalent employees) may be subject to the "A" penalty for not providing Minimum Essential Coverage ("MEC") to 95% of full-time employees during the calendar year. For 2016, the "A" penalty for not complying with the annual employer mandate is $2,160 for every full-time employee after the first 30 employees. This penalty is triggered if one full-time employee obtains subsidized coverage from the Marketplace.

Employers who do offer MEC to 95% of full-time employees may still face the ACA's "B" penalty if the coverage they offer to full-time employees does not cover at least 60% of plan costs, known as Minimum Value ("MV"), or is considered unaffordable to an employee. For 2016, employer-sponsored coverage is considered affordable if the employee's monthly share of the cost for self-only MV coverage is not more than 9.66% of (i) the Federal Poverty Level (or $95.63), (ii) an employee's Box-1 W-2 wages, or (iii) an employee's base pay. During 2016, the annual "B" penalty is equal to $3,240 times the number of full-time employees that have subsidized Marketplace coverage.

How Opt-Out Provisions Impact the Affordability Calculation

In an effort to help control costs, some employers offer employees the option to enroll in health coverage or receive additional taxable compensation. These opt-out arrangements should be offered through a Section 125 plan to avoid running into problems with the Medicare and Tri-Care prohibition on offering incentives or in any way encouraging employees who may be eligible for these programs to decline employer-sponsored coverage.

The IRS has been examining opt-out arrangements to consider how these payments might impact the determination of affordability for a variety of purposes including:

- An individual's eligibility to qualify for premium assistance when purchasing a qualified health plan from an ACA exchange,
- An individual's ability to qualify for an exemption to the individual mandate when the cost of coverage being offered is unaffordable by the ACA definition, and
- An employer's potential exposure to the ACA "B" penalty for not offering affordable coverage.

In general, the IRS considers an opt-out arrangement to be an opportunity cost that an employee must forgo when enrolling in the employer's group health plan. For example, if the cost of self-only MV coverage is $100 per month and the employer offers employees $150 per month to decline coverage, an employee who actually enrolls in the employer's plan has forgone the additional $150 to secure coverage. According to the IRS, the cost for self-only coverage that must be used to determine if employer-sponsored coverage is affordable by ACA standards (and the cost that should be reported on Form 1095-C) is $250 – the monthly single premium ($100), plus the opportunity cost ($150).

However; the IRS does not take this approach for all opt-out designs and has introduced the concept of **"unconditional"** and **"conditional"** opt-out arrangements. An opt-out payment would only be included in the employer's affordability calculation under an **unconditional** opt-out arrangement.

An **unconditional** opt-out payment is an arrangement where an employer provides an opt-out payment to an employee based solely on that employee declining coverage under his or her employer's health plan. In this scenario, no other meaningful requirements related to making sure employees have been provided with healthcare, such as requiring proof of coverage by a spouse's employer, are needed.

A **conditional** (eligible) opt-out payment would not be factored into the cost of self-only coverage when determining the affordability of health coverage, because the IRS views these arrangements as helping employees reduce the cost of alternative coverage. A **conditional** opt-out arrangement requires the employer to obtain proof that an employee has other coverage for him- or herself and all other individuals for whom the employee reasonably expects to claim a personal exemption during the taxable year in which the opt-out applies. That coverage can't be individual coverage or purchased through the Exchange. An employee that fails to provide the proper proof of alternative coverage would not qualify to receive the opt-out payment under a conditional opt-out arrangement.

The IRS is considering an employee's attestation to be an acceptable form of proof. Evidence of acceptable coverage must be provided for each plan year that the opt-out applies and for each family member for whom the employee will claim a tax exemption deduction. The evidence should be provided in a timely manner either reasonably before or after the beginning of the employer's plan year.

An employer that makes contributions to a Section 125 plan (i.e., flex credits) that may be used to purchase MEC are not treated as opt-out payments, even when employees who waive coverage may receive taxable compensation.

Until final regulations are in effect:

- Employers with opt-out arrangements adopted before December 16, 2015, may continue to exclude opt-out payments when calculating affordability.
- Employers participating in collective bargaining agreements with opt-out arrangements that were in effect before December 16, 2015, may also exclude the opt-out cost in determining affordability until the later of (i) the expiration date of the collective bargaining agreement or (ii) the effective date of the regulation.

- Individual taxpayers may treat any opt-out arrangement as an increase in their cost of coverage when figuring out what their premium tax credit eligibility is and whether or not they're eligible for an exemption from the individual mandate due to coverage costing more than a certain percentage of household income.

Next Steps

Employers who offer or are considering offering an opt-out provision may wish to establish a conditional arrangement to avoid having to include the opt-out payment in the affordability determination. Some ways employers might do that include:

- Create procedures to secure proof of other group health plan coverage from an employee who waives coverage,
- Ensure that proof is supplied for all family members whom the employee will claim a personal exemption deduction for during the taxable year in which the opt-out applies,
- Review plan documents to incorporate or update opt-out provisions, and
- Prepare effective employee communication materials explaining the opt-out provisions and the manner and timeframe in which acceptable forms of proof must be submitted.

A final word of caution: **An employer should NOT establish an arrangement that reimburses the employee (pre-tax or post-tax) for the purchase of individual insurance** (i.e. through the Marketplace or otherwise), because the employer will become subject to an excise tax of $100/day per violation.

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