

IRS Proposed Rules on Opt-Out Bonuses and Affordability

The Patient Protection and Affordable Care Act (ACA) inundated employers with new mandates and requirements, resulting in additional challenges for employers offering coverage to employees. The true scope of the level of complexity faced by some employers is further increased by the fact that IRS guidance has impacted how those employers can offer opt-out bonuses as a part of a Cafeteria Plan. This article from Gallagher spotlights the most significant ACA issues that the proposed IRS regulations have on employers trying to provide affordable health coverage when offering an opt-out bonus for employees declining health coverage.

Significant Issues Introduced by the ACA

In December 2015, the IRS issued [Notice 2015-87](#), which includes Questions and Answers that help define the impact on the affordability of employer-sponsored coverage when an employer offers its employees an opt-out bonus. As background, there are two ways to structure an opt-out bonus, either “conditionally” or “unconditionally.” A **conditional opt-out bonus** is a specified dollar amount that an employer will give an employee for declining health coverage under the employer-sponsored health plan, on the condition that the employee has coverage elsewhere (usually on a spouse’s health plan or other health plan). Generally, an employer offering a conditional opt-out bonus requires its employees to provide proof that they have other coverage in order to receive the bonus. Conversely, an **unconditional opt-out bonus** is a specified dollar amount that an employer will give an employee for declining health coverage under the employer-sponsored health plan without requiring any additional action by the employee to receive the opt-out bonus.

Notice 2015-87 effectively placed employers on notice that unconditional opt-out bonuses can negatively affect the affordability of coverage for an employee, but failed to address the impact of conditional opt-out bonuses. Affordability of employer-sponsored coverage is significant because an applicable large employer that offers minimum essential coverage that provides minimum value may still be subject to a penalty if that coverage is deemed “unaffordable.” Coverage is deemed affordable when self-only coverage under the employer’s lowest cost health plan with minimum value does not exceed 9.83% (for 2021 and indexed in future years) of the employee’s household income or satisfies any of the three affordability safe harbors introduced by the IRS.

Subsequently, in 2016, the IRS released new proposed regulations on conditional opt-out arrangements and their impact on the affordability of health coverage. The proposed regulations also introduced special rules for opt-out bonuses that are a part of Collective Bargaining Agreements (CBAs). The impact of Notice 2015-87 and the proposed regulations is addressed below.

Unconditional opt-out bonuses will make coverage less affordable for purposes of the Employer Mandate. When an employer offers its employees an unconditional opt-out bonus (an offer of a bonus based solely on the employee declining coverage under the employer’s health plan and not on an employee satisfying any other requirement, such as the requirement to provide proof of alternative coverage provided by a spouse’s employer), the IRS will consider the opt-out bonus as an additional charge for health coverage when determining its affordability for application of the Employer Mandate penalty. The IRS reasons that the opt-out bonus increases the cost to the employee when calculating the health coverage affordability because the employee has to forgo the opt-out bonus in order to participate in the health plan.

For example, Todd Smith is an employee of ABC Corp., which offers its employees coverage under a health plan that requires Todd to contribute \$3,000 for self-only coverage. ABC Corp. also makes available to Todd a payment of \$500 if



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Todd declines to enroll in the health plan. Therefore, the \$500 opt-out payment (an unconditional opt-out) increases Todd's required contribution under ABC Corp.'s health plan from \$3,000 to \$3,500 for purposes of calculating whether the coverage is affordable, regardless of whether Todd enrolls in the health plan or declines to enroll and is paid the opt-out bonus.

Conditional opt-out bonuses will not impact affordability, assuming they satisfy specific conditions. The proposed regulations provide that amounts made available under a conditional opt-out bonus arrangement would be disregarded in determining affordability, as long as the arrangement satisfies certain conditions (an "eligible opt-out arrangement"). The proposed regulations define an "eligible opt-out arrangement" as an arrangement under which the employee's right to receive the opt-out payment is conditioned on: (1) the employee declining to enroll in the employer-sponsored coverage, (2) the employee providing reasonable evidence that the employee and all other individuals expected to be tax dependents will have minimum essential coverage (other than coverage in the individual market, whether or not obtained through the Marketplace) during the period of time that the opt-out arrangement applies during the employer's health plan year, and (3) the employer must also ensure that any opt-out payment will not be made (and the payment must not in fact be made) if the employer knows or has reason to know that the employee or any other member of the employee's family does not have (or will not have) the required alternative coverage. For example, if an employee's family consists of the employee, the employee's spouse, and two children, then the employee would meet the conditional opt-out requirements 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.

Reasonable evidence of alternative coverage includes the employee's attestation (or other reasonable evidence, such as proof of alternative health coverage) that the employee and all other members of the employee's family, if any, have or will have minimum essential coverage. An eligible opt-out arrangement must require that the employees provide evidence of coverage at least once every plan year to which the opt-out arrangement applies. The employer can require the evidence of alternative coverage no earlier than a reasonable period before the beginning of the coverage period to which the eligible opt-out arrangement applies. Obtaining the reasonable evidence as part of the annual enrollment process within a few months or weeks before the beginning of the employer's next plan year meets this reasonable period requirement.

Alternatively, an employer may, but is not required to request evidence of alternative coverage to be provided later, such as after the plan year starts. This allows the employer to require evidence that the employee and other members of the employee's family have already obtained the alternative coverage. The regulations do not discuss what is considered "acceptable" evidence of alternate coverage; however, it may include documents such as health plan enrollment forms or a spouse's pay deduction for his/her employer sponsored-health plan.

Assuming all requirements of an eligible opt-out arrangement are met, then the opt-out payment may be excluded from the employer's affordability calculation when determining if the employee's contribution to health coverage is affordable for the period of time to which the opt-out payment applies. This also holds true even if the alternative coverage subsequently terminates for the employee or any other member of the employee's family, regardless of whether the opt-out payment is required to be adjusted or terminated due to the loss of alternative coverage.

For example, Todd Smith is an employee of ABC Corp., which offers its employees coverage under a health plan that requires Todd to contribute \$3,000 for self-only coverage. ABC Corp. also makes available to Todd an opt-out payment of \$500 if Todd declines to enroll in the health plan and provides health plan enrollment forms to prove that he and the rest of his family are or will be enrolled in minimum essential coverage through another source no earlier than the annual open



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period. If Todd chooses to decline coverage in the upcoming open enrollment period for ABC Corp. and provides enrollment forms to prove he and his family will be enrolled in minimum essential coverage in another health plan (other than coverage in the individual market), then ABC Corp. will be allowed to exclude the \$500 opt-out bonus when determining the affordability of Todd's coverage. Todd's required contribution for self-only coverage under ABC Corp.'s health plan is \$3,000 for purposes of calculating affordability under the ACA.

Action Steps

- Determine if your health plan is using an opt-out bonus arrangement and identify if it is a conditional or unconditional opt-out bonus arrangement.
- If you are using a newly designed unconditional opt-out bonus arrangement, then you should factor the opt-out bonus amount into the affordability calculation for the health plan.
- If you continue to use a conditional opt-out bonus arrangement, make sure that employees who opt-out of coverage attest and/or provide evidence that they and their tax dependents have or will have minimum essential coverage for the period of time the opt-out bonus covers (e.g., the employer health plan year) before annual enrollment.
- Review your coverage waiver forms to ensure that they reflect that the opt-out amount will only be paid if the employee and his/her tax dependents have other minimum essential coverage and that the waiver form is collected every year. In the employer policy, you may wish to clearly indicate acceptable timeframes for employees to produce evidence of minimum essential coverage.
- Consider how you pay employee opt-out bonuses. Although the opt-out bonus is usually expressed as an annual amount, most employers pay the bonuses on a monthly or per pay period basis. If you pay the full amount at the beginning of the year, and the employee loses the other coverage later in the year, the employee could come back into your health plan as a result of a HIPAA special enrollment. Unless your health plan has some type of "repayment" provision in the opt-out bonus or pays the amount throughout the year, the employee might end up waiving coverage for a few months and still receive the full annual opt-out amount.
- Stay tuned for more.

Employers should carefully evaluate their health and welfare plans to determine if they are in compliance with both federal and state law. If you have any questions about information contained in this Spotlight or would like additional information, please contact your Gallagher Consultant or account team member.

The intent of this analysis is to provide general information regarding the provisions of current federal laws and regulation. It does not necessarily fully address all your organization's specific issues. It should not be construed as, nor is it intended to provide, legal advice. Your organization's general counsel or an attorney who specializes in this practice area should address questions regarding specific issues.