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Opt-Out Bonuses and Medicare Eligibility

Some employers provide, or might consider providing, an opt-out bonus to employees through their cafeteria plan. Typically, with an opt-out bonus, an employer offers an employee a flat amount of taxable cash (e.g., $100 per month) if the employee waives medical coverage under the employer's plan. Prior to enactment of the Patient Protection and Affordable Care Act (ACA), the opt-out bonus could be either conditional (i.e., payable only if the employee enrolled in other coverage such as coverage under a spouse's employer's plan) or it could be unconditional (i.e., the employee only had to waive coverage to receive the cash). In July 2016, the IRS provided guidance on how employers that are Applicable Large Employers (ALEs) (generally, an employer with 50 or more full-time and full-time equivalent employees) should structure opt-out bonuses in order to ensure that their coverage is affordable. Specifically, the IRS stated that if an ALE provides an opt-out bonus that is unconditional, the amount of the cash bonus must be treated as part of the required employee contribution in order to determine if the medical coverage offered by the employer is "affordable" under the Employer Shared Responsibility Mandate.[1] As a result of this IRS guidance, many employers have taken steps to ensure that their opt-out bonus is offered on a "conditional" basis. An eligible opt-out arrangement will not adversely affect the affordability of an employer's plan. Further information on this IRS guidance, and what constitutes an "eligible" opt-out arrangement, can be found in our Spotlight, Plan Design Considerations on Opt-Out Bonuses.

One of the issues that arises when a plan offers a conditional opt-out bonus is how to identify what type of other coverage the employee must have in order to receive the additional cash. The IRS guidance provides that in order for the opt-out to be an eligible opt-out arrangement, an employee must provide reasonable evidence that the employee and his or her dependents have or will have minimum essential coverage (other than coverage in the individual market) during the period of coverage to which the opt-out arrangement applies. Sometimes, an employer will require its employees to have other coverage that is major medical coverage, which provides more than mere "minimum essential coverage." A related issue that arises is the source of coverage. Although in most cases the other coverage available to an employee will be under another employer's group health plan, there are other sources for comprehensive medical coverage. One possible source – primarily for older employees – is Medicare.

Medicare Secondary Payer Law

[1] There is currently a grandfathered provision for certain ALEs that had an unconditional opt-out bonus in effect prior to December 16, 2015. Those employers do not need to include the amount of the bonus when determining affordability until final regulations are issued. As of January 1, 2024, final regulations have not been issued.

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Under the Medicare Secondary Payer (MSP) law, plans maintained by employers with 20 or more employees (employers of any size if the individual is eligible for Medicare based on End Stage Renal Disease (ESRD)) are required to be the primary payer for employees where coverage is based on current employment with the employer. Medicare is generally the primary payer for retirees (and their spouses). Medicare is also generally the primary payer for individuals eligible for Medicare based solely on ESRD after a 30-month "coordination" period. When primary, an employer's medical plan must pay covered plan expenses as if the employee did not have Medicare. Where an employer's plan is primary, Medicare pays second and reduces its payment based on what the employer's plan has paid. In addition, employers that are primary under the MSP law may not "take into account" an employee's eligibility for Medicare. A few examples of practices that are deemed to violate this rule with respect to active employees are:

- Paying medical benefits on a secondary basis
- Offering medical coverage that supplements Medicare
- Terminating medical coverage when the individual becomes eligible for Medicare
- Imposing limitations or providing less comprehensive medical coverage to Medicare-eligible individuals
- Charging Medicare-eligible individuals higher contributions
- Using lower reimbursement rates when paying medical providers for services provided to Medicare-eligible individuals (for example, reimbursing providers at the Medicare approved charge for employees enrolled in Medicare while reimbursing a higher "reasonable and customary" amount for services provides to individuals not eligible for Medicare).

These are only a few examples of "taking Medicare into account." Guidance from the Centers for Medicare and Medicaid Services (CMS) contains a more comprehensive list. As a general rule, an employer should not take any action intended to discourage a Medicare-eligible employee from enrolling in the employer's plan or provide an incentive for an employee to enroll in Medicare rather than the employer's medical plan.

Penalties for violating the MSP law can be substantial. For example, a $11,162 (2023 value, indexed annually) per occurrence penalty for offering prohibited incentives – such as offering a Medicare-eligible employee a choice between the employer's comprehensive medical plan and a second plan that supplements Medicare coverage.

Notably, penalties for violating the MSP law are not limited to private employers but apply to all types of employers.

Medicare and Opt-Out Bonuses: Sub-regulatory Guidance

A cash opt-out bonus is a financial incentive for an employee to waive coverage under the employer's medical plan. It's clear that offering a cash incentive **only** to Medicare-eligible employees or offering a larger incentive to Medicare-eligible employees than is offered to other eligible employees to encourage them to enroll in Medicare, rather than the employer's medical plan, would be a violation of the MSP law. But, what if (as is virtually always the case) the opt-out offer is made to all eligible employees as part of a cafeteria plan?

There are no agency regulations stating that opt-out bonuses violate the MSP law if they are offered to Medicare-eligible employees. However, several pieces of sub-regulatory guidance address the issue.

First, CMS sent a letter in 2002 with informal guidance on this issue. The letter was written in response to a number of questions that had been directed to the agency. Question #3 specifically addresses the typical opt-out arrangement – i.e., a plan under which employees are permitted to choose between medical insurance and a cash amount where the same choice would be offered to everyone regardless of age or Medicare status. The question asked was whether the cash payment would be viewed as an improper incentive for those individuals to select Medicare as their primary payer. The response was that as long as the cash payment is based on the employee's election as a benefit offered under the employer's cafeteria plan, it would not be a violation of the MSP prohibition against offering a financial incentive to encourage a Medicare-eligible employee to waive coverage under the employer's medical plan and instead enroll in Medicare. Two key elements in this question and answer are that the offer is made under a cafeteria plan that satisfies the requirements of IRC Section 125, and that it be offered to all employees eligible under the cafeteria plan. As part of the question, CMS was asked if the answer would be different if the employer required the employee to demonstrate other coverage in order to receive the cash payment. CMS's response was that the answer would be the same as long as those without Medicare would also be required to demonstrate other coverage.

Second, CMS has additional guidance that some practitioners believe conflicts with CMS's 2002 guidance. Specifically, Section 70 of the current CMS MSP manual states as follows:

> "An employer or other entity is prohibited from offering Medicare beneficiaries financial or other benefits as incentives not to enroll in or to terminate enrollment

> in a GHP or LGHP that is or would be primary to Medicare. This prohibition precludes the offering of benefits to Medicare beneficiaries that are alternatives to the employer's primary plan (e.g., prescription drugs) unless the beneficiary has primary coverage other than Medicare. An example would be primary plan coverage though his/her own or a spouse's employer. This rule applies even if the payments or benefits are offered to all other individuals who are eligible for coverage under the plan. It is a violation of the Medicare law every time a prohibited offer is made regardless of whether it is oral or in writing. Any entity that violates the prohibition is subject to a civil money penalty of up to $10,360 for each violation."

Even though this statement does not specifically address opt-out incentives, the prohibition against "financial or other benefits" as incentives implies that both additional or alternative benefits and a financial incentive such as cash would be prohibited.

A second source that appears to conflict with the 2002 CMS letter is a CMS memo dated December 2014 that addresses the MSP prohibition on incentives for employers subject to either the Service Contract Act (SCA) or the Davis Bacon Act (DBA). These acts contain provisions that require employers to furnish fringe benefits to certain employees of federal service or construction contractors. In that memo, CMS states that under the MSP law employers are prohibited from encouraging or offering incentives to individuals who are eligible for, or already enrolled in, Medicare to elect enrollment in Medicare instead of enrolling in the employer's group health plan. The memo includes an example where the employer's fringe benefit funds that could be used for group medical coverage go to the employee's 401(k) account instead – i.e., the employer is giving an incentive to employees not enrolled in the employer's medical plan. CMS states that in this circumstance the employee would receive a benefit – a contribution to the 401(k) account – as a result of declining group health plan that would be primary to Medicare and that this incentive is prohibited. The memo specifically states:

> "Employees with current employment status who are Medicare beneficiaries and are covered by the SCA and/or DBA may *not* decline GHP coverage that would otherwise be primary to Medicare offered by their employers in exchange for other fringe benefits, unless they have coverage that is properly primary through another source, such as a working spouse.
>
> Where Medicare beneficiaries affected by this policy are able to decline such fringe benefits, beneficiaries are not required to enroll in the employer's GHP."

While the CMS MSP manual and the December 2014 memo are instructive, neither provides a definitive rebuke of the 2002 letter. The language in the CMS MSP manual is largely a broad statement about the prohibition against incentives. The December 2014

memo provides more detail, but describes a limited situation where an employee receives a larger 401(k) contribution in lieu of group medical coverage. Neither specifically addresses the issue of an opt-out bonus under a cafeteria plan as did the 2002 letter. Unfortunately, while the CMS manual and 2014 memo are both more recent than the 2002 CMS letter, rather than providing a clear update to the issue of cafeteria plan opt-outs to individuals whose only other coverage would be Medicare, these two documents raise issues for which we do not have an answer at this time.

One possible solution might be to offer an opt-out bonus to all employees except those who are eligible for Medicare. Arguably, this design could eliminate risk under the MSP law. If the opt-out is offered to all employees except those eligible for Medicare, that alternative design arguably might be viewed as "taking Medicare into account" because at least one of the benefits offered under the medical plan would be determined **solely** based on eligibility for Medicare. However, it is unlikely CMS would object, since this alternative would not negatively affect Medicare assets. In the alternative, the employer could limit the opt-out bonus to individuals who have certain types of other coverage such as coverage under an employer's plan where the other employer's plan is primary or coverage such as a spouse's employer's plan.

Another unanswered question that CMS is unable to address is the possible impact of the Age Discrimination in Employment Act (ADEA). Because a large majority of the employees who are eligible for Medicare will be eligible based on attaining age 65, will offering an opt-out bonus to all employees except those who are eligible for Medicare be viewed by older employees as discriminatory? What position will the Equal Employment Opportunity Commission (EEOC) – the agency that oversees age discrimination complaints – take?

Small Employers

So far, our discussion has assumed that the opt-out bonus is conditional, as defined above. ALEs are unlikely to offer an unconditional opt-out bonus because the amount of the bonus would be included when calculating the employee's required contribution for affordability under the ACA. The increased cost resulting from the addition of the amount of the opt-out bonus could easily change coverage for some employees from affordable to unaffordable. Employers that are not ALEs do not face a potential penalty if the coverage they offer is not affordable as defined under the ACA, however, so those employers could simply offer an opt-out bonus to any employee who waives medical coverage – whether the employee has other coverage or not. CMS guidance does not specifically address this issue either, as the IRS guidance discussing opt-out arrangements was issued later. The December 2014 memo assumes that an employee has other coverage that is primary to Medicare. If employers with 21 to 49 employees should decide to include an opt-out bonus, must the offer be limited to employees who

are not eligible for Medicare in order to avoid violating the MSP law? Will the offer violate the ADEA?

For very small employers – under 20 employees – the issues presented in this article would likely not be in play at all, because their plans are not subject to MSP rules or the ADEA and these employers are not subject to the ACA's employer shared responsibility rules and the accompanying affordability requirement.

Action Steps

Employers that are considering the addition of an opt-out bonus to their medical plans will need to determine what requirements they will impose on the payment of the bonus including:

- Will the bonus be conditional or unconditional, and for ALEs how will that affect affordability?
- What other coverage must an employee have in order to qualify to receive the bonus? Will eligible coverage be limited to coverage under another employer's plan? Or will other types of coverage, such as TRICARE, count?
- If coverage is limited to another employer's medical plan, will it be limited to coverage under another plan that is primary to Medicare under the MSP law? And if so, how will the employer confirm the primary position of the other employer's plan?

At this time, there is no formal guidance from either CMS or the EEOC on the status of opt-out bonuses under a cafeteria plan. As a result, employers that have or are considering adding an opt-out bonus may want to discuss their proposed design with an attorney familiar with these issues.

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.