UBA
ACA Advisor

What you need to know about the Affordable Care Act

Are Opt-Outs on the Way Out?

Opt-out payments or cash in lieu of benefits have been a staple in the employee benefits industry for many years. Employers offer individuals who are eligible to enroll in their group health plan a sum of money, typically paid monthly, to those who waive enrollment in the group health plan. Employers who offer group health plans often use opt-out payments to share the savings they receive when an employee chooses not to enroll in the benefits offered.

These opt-out arrangements can take two different structures:

- Conditional opt-outs require the employee to satisfy a condition in order to receive the opt-out payment. Typically, the condition is proof of other group minimum essential coverage (MEC).
- Unconditional opt-outs are offered to all employees and simply require the employee to waive coverage under the group health plan.

For many years, so long as employers were offering opt-outs uniformly to all benefit-eligible employees, the government had little, if any, regulation over opt-outs. However, beginning in 2015, multiple government agencies began tightening the parameters around permissible opt-outs and, in some situations, appear to restrict them completely. Employers are experiencing increased scrutiny over opt-outs from various agencies because of recent regulatory guidance.

Employers that currently offer opt-outs should evaluate their opt-out program’s structure and should consider phasing out opt-out programs in the near future.

Centers for Medicare & Medicaid Services (CMS)

Under federal regulations, Medicare is a secondary payer for many individuals who have an employer group health plan available to them, either as an employee or the dependent spouse or child of the employee. Generally, the Medicare Secondary Payer rules prohibit employers with 20 or more employees from incentivizing an active employee age 65 or older to elect Medicare instead of the group health plan, including offering a financial incentive. For many years, opt-outs that were offered to all employees and were not directed at employees who were Medicare eligible (or employees with Medicare eligible spouses) were given unofficial approval from CMS.

However, it appears that CMS is reconsidering its position and is beginning to view opt-outs, even those offered uniformly, as impermissible incentives. Although no official guidance has been given, employers have reported to their brokers that CMS has begun inquiring about and looking into opt-outs.

Employers with employees who are Medicare eligible should consult with their legal counsel and proceed with caution, or consider eliminating opt-outs altogether.

If an employer has 20 or more employees (or is a state or local government of any size), the Age Discrimination in Employment Act (ADEA) would apply. Only offering opt-outs to individuals who are not Medicare eligible could lead to claims of age discrimination.

TRICARE

If the employer has 20 or more employees and any of the employees or spouses are TRICARE-eligible, then the employer may not offer to pay, subsidize, or otherwise reimburse the cost of TRICARE coverage for employees or their spouses, as this could be seen as taking such coverage into account and incentivizing the individual to drop group health coverage. Paying cash to an employee who is TRICARE eligible (or who has a TRICARE eligible spouse) in lieu of the employee participating in group health coverage would likely violate this prohibition.

An employer's use of a cafeteria plan would not violate this TRICARE rule. From the TRICARE Policy Manual, Chapter 1:

> **1.4.1** An employer-funded benefit offered through an employer's cafeteria plan would not be considered an improper incentive, as long as it is not a TRICARE exclusive benefit. (The cafeteria plan must comply with Section 125 of the Internal Revenue Code.) Employers who offer all similarly situated employees without regard to TRICARE eligibility a choice between health insurance and cash payment equivalents are not considered in violation of the prohibition. Therefore, if a TRICARE beneficiary elects a cash payment option as a benefit offered via the employer's cafeteria plan, then this is not a violation of these provisions.

Only offering opt-outs to individuals who are not TRICARE-eligible could lead to claims of discrimination based on military status.

Individual Premium Prohibitions

For many years, employers were permitted to reimburse premiums paid for individual coverage on a tax-favored basis, and many smaller employers adopted this type of an arrangement instead of sponsoring a group health plan. However, these "employer payment plans" frequently are unable to meet all of the Affordable Care Act (ACA) requirements that took effect in 2014, and in a series of Notices and frequently asked questions (FAQs) the IRS made it clear that an employer may not either directly or indirectly pay premiums for individual policies or reimburse employees for individual premiums on either an after-tax or pre-tax basis.

Concern has arisen that some opt-out arrangements are structured as an indirect vehicle for individual premium reimbursement. Employers should take caution to ensure that they are not offering opt-outs that could be construed as reimbursement for individual premium reimbursement. For example, offering an opt-out amount that is close to the cost of a benchmark plan would be inadvisable.

There are two exceptions to this prohibition against individual premium reimbursement. First, starting in 2017, small employers can use a Qualified Small Employer HRA (QSEHRA) to reimburse individual coverage premiums. Second, starting on January 1, 2020, employers of all sizes can offer an individual coverage HRA (ICHRA) to reimburse individual coverage premiums. Both the QSEHRA and ICHRA have specific requirements that an employer must meet before an employer can reimburse individual coverage premiums.

Affordability Concerns

Opt-outs can also impact an applicable large employer (ALE) affordability calculation of their group health plan.

The IRS has determined that opt-out arrangements increase an employee's contribution for health coverage beyond the amount of the salary reduction. In December 2015, the IRS announced that it intended to propose regulations that will treat an unconditional opt-out arrangement (an arrangement providing a payment conditioned solely on an employee declining coverage under an employer's health plan and not on an employee satisfying any other meaningful requirement) in the same manner as a salary reduction for purposes of determining an employee's required contribution relating to affordability.

The IRS issued its proposed regulations in July 2016. The current regulations provide that, in determining whether employer-sponsored coverage is affordable to an employee, an employee’s required contribution for the coverage includes the amount by which the employee’s salary would be reduced to enroll in the coverage. The proposed regulations provide that if an employer makes an opt-out payment available to an employee, then the amount of the payment made under an unconditional opt-out arrangement increases the employee’s required contribution.

Further, the proposed regulations clarify that an unconditional opt-out arrangement that is required under a collective bargaining agreement’s terms in effect before December 16, 2015, will be treated as having been adopted prior to December 16, 2015. The proposed regulations also clarify that employers participating in the collective bargaining agreement are not required to increase the amount of an employee’s required contribution until the later of:

1. the beginning of the first plan year that begins after the expiration of the collective bargaining agreement that was in effect before December 16, 2015 (disregarding any extensions on or after December 16, 2015), or
2. the applicability date of these regulations with respect to sections 4980H and 6056.

This proposed regulation applies to any successor employer adopting the opt-out arrangement before the expiration of the collective bargaining agreement in effect before December 16, 2015 (disregarding any extensions on or after December 16, 2015).

The proposed regulations create a different rule for conditional opt-out arrangements. Amounts made available under conditional opt-out arrangements are disregarded in determining the required contribution if the arrangement satisfies certain conditions (eligible opt-out arrangement). If the arrangement does not satisfy those conditions, then the amounts are taken into account in determining the employee’s required contribution.

An eligible opt-out arrangement is 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 the employee's expected tax family have or will have minimum essential coverage (other than coverage in the individual market, whether or not obtained through the Marketplace) during the period of coverage to which the opt-out arrangement applies; and
3. The employer having no knowledge or no reason to know that the employee or any other member of the employee's expected tax family does not have or will not have the required alternative coverage.

The IRS has provided the following 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 offers an additional $100 per month in taxable wages to each employee who declines the coverage, the offer of $100 in additional compensation has the economic effect of increasing the employee's contribution for the coverage. 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.

Impact on "regular rate of pay" under the Fair Labor Standards Act

If the employer is located in certain western states, then the opt-out arrangement will affect the employee's "regular rate of pay." In the court case Flores v. City of San Gabriel, the Ninth Circuit Court of Appeals (which covers several western states including Alaska, Washington, Oregon, Nevada, Idaho, Montana, Arizona, California, and Hawaii) determined that when an employer pays cash to an employee for opting out of its health plan, the payment must be considered part of the employee's "regular rate of pay" under the Fair Labor Standards Act. This means that an employer would need to take the payment into account when calculating overtime for hourly workers.

Best Practices

Small employers who have no employees who are Medicare eligible, or have Medicare eligible spouses should continue to watch for further guidance on opt-out arrangements prior to each benefit year. Employers who have even one employee who is Medicare eligible (or has a spouse who is Medicare eligible) should consult with counsel. Risk-averse employers in that situation should consider phasing out their opt-outs in the near future.

Employers who are considered an ALE under the ACA that offer an unconditional opt-out in a dollar amount that would cause their offer of coverage to exceed the affordability requirements under the employer shared responsibility provisions should consult with counsel and consider eliminating their opt-out immediately. It is anticipated that the IRS may issue further guidance and regulations regarding conditional opt-outs, so ALEs with conditional opt-outs that are currently considered "eligible opt-outs" should continue monitoring federal guidance.

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