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THE NEW "ELIGIBLE OPT-OUT ARRANGEMENT" -- JUST REQUIRING PROOF OF OTHER COVERAGE IS NOT ENOUGH

Employers that offer opt-out programs providing additional cash compensation to employees who decline employer group health plan coverage are experiencing a bumpy ride as of late because recent ACA guidance is taking aim at such programs. Employers, particularly applicable large employers (ALEs) will want to review their medical opt-out payment programs now for ACA affordability calculations related to their 2017 plan year, based on newly proposed IRS regulations.

On July 8, 2016 the IRS released proposed regulations implementing some of the rules previously announced in IRS Notice 2015-87 last December. Notice 2015-87 signaled the IRS' intent to factor opt-out payments into the amount of the employee's required contribution for purposes of determining the affordability of the related employer sponsored group health plan. The proposed regulations confirm the IRS position on the effect of opt-out programs on the ACA affordability calculation. These new rules are proposed to be effective for plan years beginning on or after January 1, 2017. Final regulations are expected before the end of 2016.

At the outset, to be clear, affordability is an ACA issue and the new rules discussed here concern employers that are considered ALEs, or ALE members in an aggregated ALE group, under the ACA employer mandate rules. The new rules will not affect "small" employers that do not have ALE status for the applicable year in question.

ACA AFFORDABILITY

Affordability and the employee's required contribution for single only coverage is relevant under several ACA provisions including, for example, an individual's eligibility for a federal advance premium tax credit (APTC) based on household income, and the exemption from the individual mandate penalty, also based on household income.

Today's focus, however, is ACA affordability from the employer perspective. For employers who are ALEs, the ACA provides that such ALEs:

- May be subject to possible excise tax penalties (the B-Tax penalty) if coverage offered to full-time employees requires a contribution for single only coverage that exceeds 9.5% of the employee's income measured using one of the three available safe harbor methods (as indexed, will be 9.69% for plan years beginning in 2017), and

- Must report offers of coverage and the full-time employee's required contribution for single only coverage on line 15 of IRS Form 1095-C.

Many ALEs and ALE members mastered the affordability calculation for 2015 and made adjustments to the required contribution for purposes of avoiding possible excise tax penalties applicable to 2015 plan years, and then reported the required contribution on the corresponding 2015 calendar year Form 1095-C filings.

IRS POSITION ON THE EFFECT OF OPT-OUT PAYMENTS ON AFFORDABILITY

The first shot across the opt-out program bow came in December of 2015 as part of IRS Notice 2015-87, in which the IRS stated that opt-out payments are economically equivalent to salary reduction amounts. Therefore, employee contributions for single only coverage should be determined based on amounts employees must forgo to enroll in coverage, regardless of whether the amount forgone is salary reduction or the available opt-out payment. Accordingly, an employee's economic cost to enroll in the employer group health plan, according to the IRS, includes both the salary reduction amount plus the amount of the available opt-out payment that the employee must forgo.

Notice 2015-87 created a distinction between conditional (restricted) and unconditional (unrestricted) opt-out arrangements. The rules suggested for such arrangements were immediately waived in most cases for 2016 using transition rules issued in the same Notice, pending the issuance of regulations. Proposed regulations have now been issued and final regulations are anticipated by the end of 2016.

IRS PROPOSED REGULATION REGARDING ACA AFFORDABILITY AND THE EXCEPTION FOR "ELIGIBLE OPT-OUT ARRANGEMENTS"

The IRS proposed regulation creates a general rule related to opt-out payments and then an exception to the general rule for "eligible opt-out arrangements."

<u>The General Rule for Opt Out Payments</u>

- The amount of an opt-out payment <u>made available</u> to an employee under an opt-out payment plan will <u>increase</u> the employee's required contribution for purposes of determining the affordability of the related employer sponsored plan.

- The <u>increase</u> in the employee's required contribution applies REGARDLESS of whether the employee actually enrolls in the eligible employer sponsored plan or declines to enroll in the coverage and is paid the opt-out payment.

In other words, the mere availability of the opt-out payment to full-time employees requires the inclusion of the available opt-out payment amount in the affordability calculation for each full-time employee, in addition to any amount the employee is required to contribute toward the cost of single only coverage. Moreover, the increased amount (the employee required contribution PLUS the amount of the available opt-out payment) must then be reported on line 15 of the 2017 IRS Form 1095-C issued in the spring of 2018 – regardless of whether the employee is enrolled in the employer's offered coverage.

IRS Limited Exception for "Eligible Opt-Out Arrangements"

The IRS has created a limited exception for eligible opt-out arrangements for ACA affordability purposes. In effect, the amount of an opt-out payment made available to an employee under an eligible opt-out arrangement does not increase the employee's required contribution for purposes of determining the affordability of the related employer sponsored plan.

An "Eligible Opt-Out Arrangement" is defined in the proposed regulations as follows:

- The employee declines to enroll in the employer's group health plan coverage
- The employee provides reasonable evidence that the employee and all individuals in the employee's expected tax family have (or will have) MEC through another source – *other than coverage purchased in the individual market*
    - Reasonable evidence can be proof of other MEC coverage or a signed employee attestation
    - The reasonable evidence/attestation must be provided every plan year – either during open enrollment or after the start of the plan year
    - Expected tax family includes all individuals for whom the employee reasonably expects to claim a personal exemption for the taxable year or years covered by the opt-out arrangement time period

[RAS Comment: A signed employee attestation may be the most convenient option for employers. Note, however, that attestations (or, alternatively actual proof of other coverage) apply to the employee AND any spouse (domestic partner in lieu of spouse if applicable under the employer's plan) AND any dependent children who are reasonably expected to be tax dependents of the employee. This is much more restrictive than the employee just waiving

coverage for him or herself. Also, attestations/proof may be complicated if the opt-out plan is non-calendar year so that the opt-out arrangement time period spans two tax years.]

In addition:

- The eligible opt-out arrangement must provide that any opt-out payment will not be made if the employer knows or has reason to know that the employee or any member of the employee's tax family does not or will not have other MEC coverage through another source

- If the other MEC coverage terminates during the year, the amount of the opt-out payment may continue to be excluded from the employee's required contribution for the remainder of the opt-out period, even if the opt-out payment is terminated or adjusted due to the loss of the other coverage

[RAS Comment: These last two requirements above, read in tandem, suggest that employer policies and procedures related to an eligible opt-out arrangement must require the employee to notify the employer if the employee or any tax dependent subsequently loses other MEC coverage and, further, that the opt-out payment should be adjusted/terminated as a result of the loss of coverage that is not replaced.

Even in cases of loss of coverage during the opt-out time period, however, the employer receives the benefit of not having to increase the employee's required contribution for purposes of determining the affordability of the related employer sponsored plan, and for Form 1095-C reporting on Line 15.]

Employers with ALE status for 2017 should evaluate these new rules and their impact on affordability testing as soon as possible. As you can see, the new requirements are more complex than simply requiring proof of other coverage for the employee. These proposed rules may undergo some fine tuning in connection with the release of the final regulations.

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Please contact me if you have any questions.

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