

# REFORM UPDATE

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## TREATMENT OF OPT-OUT BONUSES WHEN DETERMINING AFFORDABILITY

The Internal Revenue Service (IRS) and the Department of Treasury recently released a Notice of Proposed Rulemaking addressing a number of issues. The rules include clarification on premium tax credits in the Marketplace, as well as an update on the individual shared responsibility rules. These sections do not have a direct impact on employers.

However, the new proposed rules also address the treatment of opt-out bonuses when determining affordability. An opt-out bonus is money offered to eligible employees who decline employer-sponsored health plan coverage. In theory, the opt-out bonus provides a financial incentive for employees to consider other plan options that may be available, such as coverage through a spouse's employer. Opt-out bonuses are offered at an employer's discretion.

This Reform Update details these new proposed regulations and their potential effect on opt-out bonuses. Employers that offer opt-out bonuses need to pay close attention to these new rules. A number of steps must be taken to continue excluding the opt-out bonus from the affordability calculation.

To avoid any possibility of penalties under the "pay or play" rules, employers need to offer minimum-value, affordable coverage to all full-time employees. At least one of the available health plans must satisfy this requirement. In 2017, a plan is considered affordable if the cost for single coverage does not exceed 9.69 percent of the employee's household income. Because most employers do not have access to employee household income, the IRS offers a number of safe harbor test options. Employers can test affordability on the Federal Poverty Level (FPL), the rate of pay or box 1 of the W-2.

The initial regulations were unclear regarding how to test affordability when employees are offered an opt-out bonus. In general, the IRS indicates that the cost of coverage should include any employee contribution plus any bonus offered for waiving coverage in the employer-sponsored health plan. The IRS believes the real cost to the employee is the required contribution plus any funds they have to forgo when electing coverage.

In the December 2015 guidance, the IRS indicated that this is the case for non-conditional opt-out bonus arrangements. A non-conditional opt-out bonus is paid when an employee declines coverage, and is subject to no additional requirements. This type of bonus must be added to contributions when testing affordability. For example, ABC Company's lowest-cost 60-percent value plan has a single

contribution of \$120 per month. ABC offers \$50 per month to any employee who opts out of ABC Company's plan. ABC would test affordability on \$170 per month (\$120 + \$50). This is also the amount that would be reported on line 15, if required, of the Form 1095-C.

The December guidance provided transitional relief to employers that communicated non-conditional opt-outs prior to December 16, 2015. Employers were not required to add in the opt-out bonus when testing affordability. However, these new rules apply to plan years beginning on or after January 1, 2017. If your organization maintains a non-conditional opt-out bonus, it must be included in affordability testing for your first plan year beginning on or after January 1, 2017.

An additional potential extension on non-conditional opt-out arrangements is provided to plans governed by a collective bargaining agreement (CBA). An unconditional opt-out, required under the terms of a CBA in effect before December 16, 2015, will be treated as being adopted prior to December 16, 2015. The opt-out bonus does not need to be included in the affordability test for the plan offered by a union until the beginning of the first plan year following the expiration of the CBA in place prior to December 16, 2015.

The IRS guidance treats conditional opt-out bonuses differently. The IRS believes a conditional opt-out is less obvious, because it places conditions on when an employee can receive the opt-out bonus. A common condition is to provide proof of other coverage. Employees could decline enrollment in the employer's plan without providing proof of coverage, but they would be ineligible for the opt-out bonus.

These new rules allow only **eligible opt-out arrangements** to exclude opt-out bonuses from the affordability calculation. Eligible opt-out arrangements need to meet specific requirements (beyond a general conditional opt-out) in order for the opt-out amount to be excluded. An eligible opt-out arrangement is one in which an employee's right to receive the opt-out payment is conditioned upon:

1. An employee declining to enroll in employer-sponsored coverage
2. The employee providing "reasonable evidence" that all individuals in the employee's expected tax family will or expect to have minimum essential coverage during the time period covered by the opt-out
  - The tax family includes the employee and all other individuals for whom the employee reasonably expects to claim a personal exemption deduction for the taxable year or years covered by the opt-out time period
  - The minimal essential coverage **does not include** coverage purchased in the individual market, whether or not obtained through the Marketplace
  - Reasonable evidence can include an employee attestation that all members of the employee's expected tax family have or will have minimum essential coverage. Employers can require other reasonable evidence, such as proof of the other minimum essential coverage
3. The arrangement **not providing any opt-out** payment 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 required alternative coverage.

4. Evidence of minimum essential coverage must be provided no less frequently than every plan year to which the opt-out arrangement applies. The evidence must be provided no earlier than a reasonable time period before the period of coverage to which the opt-out applies. It would be reasonable for evidence to be provided at the annual enrollment period associated with the plan year.

The amount of the opt-out bonus can be excluded from the affordability calculation as long as reasonable evidence is provided for the entire plan year, even if the alternative coverage terminates at some point during the year.

The rules include a number of examples to demonstrate the impact of an opt-out bonus on the affordability calculations.

**Example 1:** Taxpayer B is a full-time employee of Employer X, which offers one coverage option under an employer-sponsored health plan to full-time employees. Employees must pay \$3,000 in contributions annually for single coverage under the plan. If B declines to enroll, X offers a \$500 opt-out bonus. No conditions other than declining coverage are placed on the opt-out bonus. In this scenario, Employer X needs to calculate affordability on a \$3,500 (\$3,000 + \$500) employee contribution. This applies if B elects coverage or opts out of coverage.

**Example 2:** Same facts as in Example 1, except the availability of the opt-out payment is conditioned not only on declining coverage, but also providing reasonable evidence that B and all members of B's tax family will be enrolled in minimum essential coverage through another source (other than coverage in the individual market). B's tax family includes spouse C, who is an employee of employer Y. During open enrollment, B declines coverage and provides reasonable evidence B and C will have minimum essential coverage under Y's plan. B is eligible for the opt-out amount. Since this arrangement is considered an eligible opt-out arrangement, affordability for Employer X plan is calculated on the \$3,000 employee contribution.

**Example 3:** Same facts as in Example 2, except that B and C have 2 children that B expects to claim as tax dependents in the taxable year coinciding with X's upcoming plan year. B declines coverage and provides reasonable evidence that B and C will have minimum essential coverage under Y's plan. However, B does not provide reasonable evidence that the two children will have minimum essential coverage from another source. In this case, B **is not eligible** for the \$500 opt-out bonus. B did not provide evidence that all dependents who are members of his tax family have minimum essential coverage elsewhere. B can still decline coverage, but cannot receive the opt-out bonus. Since this arrangement is considered an eligible opt-out arrangement, affordability for Employer X's plan is calculated on \$3,000 employee contribution.

A final example includes an opt-out policy that requires the employee only to provide reasonable evidence of other coverage for the employee. Since the opt-out does not require reasonable evidence for all members of the tax family, it is not considered an eligible opt-out arrangement. As a result, the opt-out bonus amount must be included in the affordability calculation.

These rules create additional steps for employers who want to offer an opt-out bonus, but would like to exclude the bonus amount from the affordability calculation. Employers need to create a policy that directly spells out the requirements to be considered an eligible opt-out arrangement. The following key points should be included:

- A requirement that the employee declines to enroll in employer-sponsored coverage
- The employee must provide reasonable evidence that the employee and all other individuals in the employee's expected tax family will or expect to have minimum essential coverage during the time period covered by the opt-out
  - Define "tax family"
  - Specify that the other minimum essential coverage cannot include coverage purchased in the individual market, whether or not it was obtained through the Marketplace
- Reasonable evidence can include an employee attestation that the employee and all other members of the employee's expected tax family have or will have minimum essential coverage
  - Review your opt-out language
  - Most employers will need to add the details required to be considered an eligible opt-out arrangement
- A statement that 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 required alternative coverage, then the opt-out bonus will not be payable
- Specify the timeframe for when evidence of minimum essential coverage must be provided. Make sure evidence is required annually to continue receiving the opt-out bonus.

Since many organizations are already making decisions for 2017, employers should address these changes now as they will affect annual enrollment communications. However, changes only need to be made to create an eligible opt-out arrangement to exclude opt-out bonus amounts from affordability testing. If your organization wants to maintain a non-conditional opt-out bonus, that is permitted. You simply have to add the amount of the opt-out bonus to the lowest-cost single contribution when testing for affordability. This modified amount is used to test affordability for all full-time employees, not just the individuals who waive coverage.

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