Employers Need To Be Aware Of Potential Pitfalls Of Providing Opt-Out Incentives To Company Health Insurance

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In recent proposed regulations, the Internal Revenue Service (IRS) addressed how the Affordable Care Act (ACA) impacts the use of employer opt-out incentives, which are payments to employees who decline an employer's group health plan. The proposed regulations correlate to previous guidance issued by the IRS in 2015. Employers who do not offer group health coverage that is affordable, as defined under the ACA, risk significant penalties. For 2016, group health coverage is considered affordable if the employee's cost for the least expensive, self-only coverage under the plan does not exceed 9.66% of the employee's annual household income. However, IRS safe harbors available to employers apply a lower threshold of 9.5% of W-2 income, rate of pay, or the Federal Poverty Level. The IRS has determined that opt-out incentives may impact a group health plan's affordability by increasing the cost of the coverage an employee elects by the amount of the foregone incentive. The IRS's guidance recognizes two types of opt-out arrangements: (1) unconditional opt-out payments; and (2) eligible opt-out arrangements. An unconditional opt-out payment does not require an employee to show proof of other coverage, which results in the amount of the incentive being added to the employee's cost of coverage, thereby impacting the affordability of such coverage. An employer may avoid this impact on its plan's affordability by administering an eligible opt-out arrangement, which requires "reasonable evidence" that the employee and his/her tax dependents have minimal essential coverage from a source other than the individual market place.

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Reasonable evidence can be a mere attestation by the employee and does not have to identify the other coverage. This evidence must be obtained annually (generally at the beginning of the plan year) for every year to which the opt-out incentive applies. Also, the employer's cafeteria plan should be amended to include the opt-out incentive arrangement. The proposed regulations apply to opt-out incentives beginning January 1, 2017, while the IRS's prior guidance impacts opt-out incentives in 2016. Employers who offer, or are considering offering, opt-out payments should review their arrangements in light of the relevant IRS guidance.