

HEALTH CARE AND THE ACA: IRS FORMALIZES POSITION ON OPT-OUT PAYMENTS

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On December 16, 2015, the IRS, the Department of Health and Human Services, and Department of Labor issued Notice 2015-87, which provides guidance on the application of various provisions of the Affordable Care Act (ACA) to employer-provided health coverage. [The guidance can be found here.](#)

Part III of the notice clarifies certain aspects of the employer shared responsibility provisions of Internal Revenue Code §4980H (the so-called “play-or-pay” penalty provisions). Question and answer nine provides much anticipated guidance on the relationship between medical plan opt-out payments and the 9.5 percent affordability threshold under the play-or-pay affordability safe harbors.

The IRS Position on Opt-Out Payments

Before Notice 2015-87 was issued, IRS representatives had informally expressed the view that taxable opt-out payments to employees who waive coverage should be added to the employee’s premium share for purposes of determining affordability under the ACA’s play-or-pay penalty provisions. In light of the absence of any authoritative guidance on the issue, pragmatic practitioners and consultants counseled a wait-and-see approach.

For all practical purposes, the wait is over, although important issues await future guidance. In Notice 2015-87, the IRS formalized the view that the required contribution toward coverage for play-or-pay purposes should include an **unconditional** opt-out payment. The IRS’s reasoning is revealed in the following example:

[I]f an employer offers employees group health coverage through a § 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.

According to the notice, an **unconditional** opt-out payment is “an arrangement providing for 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 related to the provision of health care to employees, such as a requirement to provide proof of coverage provided by a spouse’s employer.”

Implications of the IRS Position

A simple example illustrates the implications of the position taken by the IRS in Notice 2015-87:

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For each calendar month of a given year, full-time employee Smith is required to pay \$92 per month for the lowest cost self-only, minimum value medical coverage offered by her employer. Assume this amount is equal to or less than 9.5 percent (as adjusted) of the mainland single federal poverty line for that year. Her employer pays an opt-out cash benefit of \$1,200 to employees who waive coverage under the employer's plan. The receipt of the payment is conditioned solely on the employee declining the employer's offer of coverage. Under the IRS guidance, the employee's required contribution for health coverage is \$192 per month. This amount consists of the \$92 employee premium share plus \$100 per month lost opportunity cost (i.e., the \$1,200 annual opt-out payment divided by 12).

If the opt-out payment **is not** added to Smith's cost for self-only coverage, and employer coverage includes dependent coverage, Smith's employer could use Code 1A for line 14 of Form 1095-C. Assuming the employer offers coverage to 95 percent or more of its full-time employees for every month of the year, the employer could not be liable for a penalty if Smith were to waive coverage and enroll in subsidized marketplace coverage.

Under Notice 2015-87, the opt-out payment would be added to Smith's cost for self-only coverage, and Smith's employer would then use Code 1E for line 14 of Form 1095-C. Whether the employer would be subject to the so-called "B" penalty if Smith were to waive coverage and enroll in subsidized marketplace coverage would depend on whether the cost of coverage—\$192 per month, \$2,304 annually, in this example—exceeds 9.5 percent (as adjusted) of Smith wages.

Future Guidance

The IRS intends to propose regulations reflecting its opt-out payment position and requesting comments on the treatment of employer offers of opt-out payments. The proposed regulations are expected to address and request comments on the treatment of opt-out payments that are conditioned not only on the employee declining employer-sponsored coverage, but also on satisfaction of additional conditions (such as the employee providing proof of having coverage provided by a spouse's employer or other coverage).

Effective Dates

The effective date of the IRS position depends on when the opt-out arrangement was adopted:

- With respect to arrangements adopted **after** December 16, 2015 ("non-relief-eligible opt-out arrangements"), the IRS anticipates that the regulations will require employers to include an unconditional opt-out payment as part of the employee's required contribution for ACA reporting purposes, and will treat such payments as increasing an employee's contribution for play-or-pay penalty purposes.
- For all other arrangements, the IRS anticipates that the regulations will apply only for periods after the issuance of final regulations. Thus, until regulations are issued, employers who maintain "relief-eligible" arrangements are not required to increase the amount of an employee's required contributions for ACA reporting purposes (Form 1095-C), and will not be treated as increasing an employee's contribution for play-or-pay penalty purposes.

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The IRS will treat an arrangement as having been adopted **after** December 16, 2015 **unless**:

- The employer offered the opt-out arrangement (or a substantially similar opt-out arrangement) with respect to health coverage provided for a plan year including December 16, 2015;
- A board, committee, or similar body or an authorized officer of the employer specifically adopted the opt-out arrangement **before** December 16, 2015; or
- The employer had provided written communications to employees on or before December 16, 2015, indicating that the opt-out arrangement would be offered to employees at some time in the future.

Employers should carefully determine whether their arrangements qualify as relief-eligible arrangements under the IRS guidance. An employer that intends to continue such an arrangement into the future may want to maintain the arrangement “as is” until future guidance or final regulations are issued. Although the IRS appears to have exempted opt-out payments that are conditioned not only on the employee declining employer-sponsored coverage, but also on satisfaction of additional conditions (such as the employee providing proof of having coverage provided by a spouse’s employer or other coverage), conservative employers will want to wait until further guidance is issued before implementing an arrangement that includes an opt-out payment.