ACA CONSIDERATIONS REGARDING CASH OPTIONS AND OPT-OUT PAYMENTS

[Through our endorsement with the Iowa Association of School Boards (IASB), we have worked with IASB to draft a Special Report on the same topic discussed here. Therefore, some of the same information may be provided in both the IASB Special Report and in this document. If you receive both, however, we would encourage you to read both as some additional information may be provided or discussed.]

For quite some time, we have recognized the detrimental effect on the performance and long term stability of a group health plan for those employers who offer cash options or opt-out payments to employees who waive health plan coverage. When employees have the option to receive cash if they waive coverage, there’s an incentive for healthy employees with access to coverage through a spouse or elsewhere, to waive coverage. This adverse selection can be detrimental to the health plan and result in increased costs for both employees and the employer. It is because of these concerns we have worked with our clients to gradually eliminate these arrangements. Now, there may be an even greater reason to at least begin the process of moving away from cash incentives for employees who waive health plan coverage.

Common Scenarios and ACA Concerns

Here are a couple of situations we often see: (1) employers provide employees with a set dollar amount through a cafeteria plan (sometimes called “flex credits”) that can be used to purchase health coverage and other benefits, or that can be taken in cash (referred to as “cashable credits”), or (2) employers provide an “opt-out” payment if an employee shows proof of other coverage and waives the district’s group health plan coverage. Now, there is uncertainty about how these arrangements will impact the affordability calculation under the ACA Employer Shared Responsibility provision. Will the credits or opt-out payments that employees could have received in cash as part of their taxable income remain employer contributions, or do they become employee contributions when calculating affordability?

The concern is if cashable credits or opt-out payments are treated as employee contributions, it may have an impact on whether an employer’s coverage meets the affordability requirement which, in turn, could then impact whether the employer incurs a penalty. The annual penalty for not meeting the affordability requirement is $3,000 per full-time employee who purchases coverage through the state exchange and receives a premium tax credit.

Currently the IRS has not provided formal written guidance on this issue as it relates to the Employer Shared Responsibility provisions so it is uncertain how the IRS will treat various types of cash options and whether any could trigger ACA penalties for employers. Our intent is to make you aware of the issue, so that you may consider potential implications and determine the best course of action for your organization.

ACA Employer and Individual Shared Responsibility Provisions

It is important to note that ACA includes Employer and Individual Shared Responsibility provisions, both of which include an affordability determination.

Under the Employer Shared Responsibility provision, employers with at least 50 full-time employees (including full-time equivalents) during the preceding year, must, among other things, offer coverage
that is affordable in order to avoid penalties. Coverage is deemed affordable for an employee if the employee’s required contribution does not exceed 9.5% of his or her income based on one of three safe harbors (W-2, rate of pay or the federal poverty level). IRS regulations do not specifically address how flex credits that an employee may elect to use to pay for health coverage, or opt-out payments that an employee may receive for declining coverage, will impact affordability under the Employer Shared Responsibility provision.

The Individual Shared Responsibility provision requires most individuals to purchase health coverage or pay a penalty. Certain individuals may be exempt from the penalty if they do not have access to affordable coverage.

It is in the context of the Individual Shared Responsibility provision, and the determination of whether an individual has access to affordable coverage through an employer, that the IRS addressed the impact of employer contributions to a Section 125 cafeteria plan. The regulations provide that in order to count flex credits as an employer contribution for affordability purposes, three conditions must be met:

1. The employee cannot have the option to take the flex credit as a taxable benefit (i.e., cash);
2. The flex credit may be used to purchase minimum essential coverage (i.e., group health plan coverage);
3. The flex credit may only be used to pay for benefits providing medical care under Internal Revenue Code Section 213.1

Although the IRS issued this guidance as part of the Individual Shared Responsibility provision and not the Employer Shared Responsibility provision, in other contexts affecting employers the IRS has traditionally treated cashable flex credits as employee contributions. For example:

- Employer flex credits that an employee may contribute to a health FSA or receive in cash are treated as employee salary reductions and count toward the health FSA limit, while employer flex credits to a health FSA that cannot be taken in cash are treated as employer contributions.2
- A similar approach is taken under the rules for determining whether health FSAs qualify as excepted benefits where employer flex credits that can be taken in cash are treated as employee salary reductions.3

Both examples are consistent with proposed cafeteria plan regulations which describe salary reductions as being made “pursuant to employees’ elections to reduce their compensation or to forgo increases in compensation.”4 Although it is not certain whether the IRS will treat cashable flex credits or opt-out payments as employee or employer contributions as it relates to the Employer Shared Responsibility provision, it is reasonable to expect the IRS to follow the same rules they have applied in similar situations, rather than apply an inconsistent set of rules. If treated as employee contributions, the flex credits that can be taken in cash and opt-out payments that an employee could receive, would be considered part of the employee’s required contribution toward the cost of coverage for affordability purposes under the Employer Shared Responsibility provision.

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2 See IRS Notice 2012-40
To give an example of how the rules may be applied, let’s say an employer does not require employees to contribute anything toward the cost of single coverage. However, if an employee declines the employer’s health insurance and can prove they are enrolled in other group coverage, the employer will pay the employee $500 per month as taxable compensation (or will give a choice to take that amount as cash or use it toward other benefits). In this example, based on the rules traditionally applied by the IRS in the examples above, the monthly cost to employees for single coverage for affordability purposes would be $500, not $0. The reasoning behind this conclusion is that the employee must forgo the $500 per month in additional compensation in order to enroll in the plan.

Conclusion

The bottom line is that offering cashable flex credits or opt-out payments for employees who decline the employer’s coverage may have an impact on whether that coverage meets the affordability requirement of the Employer Shared Responsibility provision. Until the IRS issues formal guidance, or until we begin to see how the employer penalties are administered and enforced, there is no clear answer as to how cash options and opt-out payments will be treated for determining affordability.

Recommendations

Given the uncertainty, the biggest question will be “What should we do?”

Employers who do not offer any type of cash option – in the form of flex credits, opt-out payments or otherwise as part of taxable income – do not need to do anything. Employers who do, should work with their broker, consultant and/or legal counsel to determine the best course of action. It is important to keep in mind that in addition to the potential for ACA penalties, there are also plan performance considerations that should be discussed.

We recognize the practical difficulties with adjusting or eliminating these types of arrangements. Bargaining considerations and union negotiations may be involved for some employers; the reality for some employees that the cash option or opt-out payment is a significant source of income; the timing of open enrollment and plan renewals may be near or even past in order to consider any changes this year. All these play a significant role in if and when employers may adjust or eliminate these arrangements. In our experience, we have found it takes time and involves education of all involved.

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