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COMPLIANCE ALERT

Opt-Out Incentives (Cash-in-Lieu of Benefits)

Some employers choose to offer an opt-out incentive or cash-in-lieu of benefits for eligible employees who choose to waive the benefits offered by the employer. For example, the employer may offer a monthly cash incentive to those who waive the employer's offer of medical coverage. Although such incentives are generally permitted (subject to any carrier restrictions), there are several things to consider when determining the design as outlined herein.

Carrier Restrictions

Any opt-out incentive should be discussed with the carrier, because some carriers have their own restrictions around such practices (e.g. in order to maintain participation).

Types of Incentives

Most commonly, the incentive is provided as cash. The cash provided should be treated as additional taxable compensation and should be included as part of the cafeteria plan to avoid issues of constructive receipt (which may have additional tax consequences). There is flexibility in how the cash is provided, concerning both amount and timing. Some employers choose to provide an incentive that is approximately the same amount as the employer contribution toward the coverage, whereas others choose to provide a much smaller incentive. Whatever the incentive amount, although it could be provided in a lump sum up front, it is safest to provide it as a per pay period or monthly incentive to avoid issues with employees who choose to enroll (e.g. due to a HIPAA special enrollment right) or who lose eligibility mid-year.

If there is a desire to provide the incentive on a tax-favored basis, it may be possible to provide the incentive as a health FSA or HSA contribution. An HSA contribution would be possible only for those who are enrolled in a qualifying HDHP elsewhere and are HSA-eligible; it would also need to be offered through the employer's cafeteria plan to avoid violating comparability rules. The health FSA contribution would need to be limited to the greater of $500 or a match of any employee contribution to maintain excepted benefit status and avoid violating healthcare reform requirements.

Eligible Individuals

Although it is possible to limit who is eligible for an opt-out incentive upon receiving a waiver of the employer's benefits, the safest approach is to offer the opt-out to all non-Medicare eligible employees who waive, or to limit it to those who show proof of other group coverage. The reasons for this are discussed below.

<u>Healthcare Reform Prohibits Paying for Individual Coverage</u> – Current agency guidance prohibits employers from reimbursing employees for individual health insurance. Reimbursement of individual health plans, whether on a pre-tax or after-tax basis, creates a group health plan that will fail to satisfy various healthcare reform requirements. An employer offering such an arrangement could be subject to

penalties of up to $100/day per affected individual. Therefore the employer should not provide an opt-out incentive tied to proof of individual coverage.

HIPAA Nondiscrimination Rules – Employers are prohibited from incenting high claimant/high risk individuals to not enroll in the group coverage. Such practice violates HIPAA's nondiscrimination rules based on health factors. The argument is that such individuals have to pay more for the same coverage because they have to forego the additional cash in order to actually obtain coverage. The biggest risk to the employer is that the individual could ultimately come back and make a discrimination claim if issues with medical coverage should arise in the future. Therefore the opt-out incentive should not be limited only to those who might be considered high claimants.

§125 Nondiscrimination Rules – In some cases, there may be a desire to offer the opt-out incentive only for certain plan options (e.g. 1 of 3 different medical plan options) or to a certain category of employees. Assuming the opt-out incentive is included in the cafeteria plan, if the employer chooses to limit which plans or individuals are eligible for the opt-out, it may be necessary to run discrimination testing to ensure doing so doesn't cause the cafeteria plan to discriminate in favor of the highly compensated employees.

Government-Sponsored Coverage – For those enrolled in governmental coverage (e.g. Medicare, Medicaid, or TRICARE), requiring proof of coverage may be a problem; it's unclear.

- Medicare Secondary Payer (MSP) rules require that Medicare eligible/enrolled individuals be offered the same benefits and not be incentivized not to take the employer's group health plan when the employer's group health plan is considered the primary payer. The employer's plan is the primary payer to age-based Medicare if the employer has 20 or more employees, and to disability-based Medicare if the employer has 100 or more employees. There is informal guidance indicating that so long as the additional cash (incentive) is available to all who show proof of other coverage and not just to those providing proof of Medicare, it is okay. That being the case, the current CMS manual does not reflect such views, and therefore the conservative approach is to avoid providing the opt-out incentive to those eligible for or enrolled in Medicare.
- Similarly, federal law prohibits employers from providing financial or other incentives for a TRICARE eligible employee not to enroll (or to terminate enrollment) under a health plan that would otherwise be primary to TRICARE. However, unlike the guidance from CMS for the MSP rules, guidance indicates an opt-out incentive for TRICARE participants is generally okay so long as it is not available only to those enrolled in TRICARE.

Affordability (Applicable Large Employers) – An applicable large employer (50 or more FTEs) must offer minimum value coverage to full-time employees that is considered "affordable" to avoid potential penalties under §4980H(b). When determining the employee contribution for the medical coverage, IRS guidance indicates that the amount of an opt-out incentive is added to the employee contribution amount if the opt-out is unconditional (i.e. available to all who waive), but not if it meets the criteria for a conditional opt-out (e.g. available only upon enrollment in other group health coverage). So, for example, consider an employee cost for single health coverage of $125 per month and a monthly cash opt-out incentive of $75 if coverage is waived. If the opt-out incentive is available to any eligible employee who waives coverage (unconditional), the employee contribution reported on Line 15 of Form 1095-C for affordability purposes is $200 ($125 + $75). However, if the opt-out incentive is available only to eligible employees who waive coverage AND show proof of other group health coverage under another employer's plan (conditional), the employee contribution for affordability purposes is $125.

NOTE: For opt-out incentives in place prior to December 16, 2015, regardless of whether the opt-out is conditional or unconditional, there is transition relief so long as the program remains substantially the same. In other words, the incentive is not considered for purposes of the affordability calculation.

Summary

Employers may be interested in offering an opt-out incentive to encourage individuals not to enroll in employer-sponsored benefits or to compensate those who do not need the employer-sponsored coverage. Regardless of the intent, if the employer would like to provide such incentive, the employer should carefully consider the plan design to ensure it doesn't cause any issues with the carrier or with the various compliance requirements as discussed above.

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