



# ABD Compliance Alert

## Opt-Out Credits May Affect Pay or Play Affordability Calculation in 2017

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In our [March ACA Potluck Office Hours webinar](#) discussing [IRS Notice 2015-87](#), we addressed the IRS intent to issue regulations adding the value of an opt-out credit to the pay or play affordability calculation. As discussed below, the IRS has issued [new proposed regulations](#) providing more detail on this issue.

The IRS intends to finalize these regulations before the end of 2016, and for the rules to be applicable for plan years beginning on or after January 1, 2017.

### Background: Pay or Play Affordability Calculation

The ACA defines coverage under an employer-sponsored plan to be affordable for an employee if the employee-share of the plan's lowest cost monthly premium for self-only coverage that provides minimum value does not exceed 9.66% (in 2016) of the employee's household income. This monthly dollar amount is generally reported to employees and the IRS at the end of each year on the Form 1095-C, Line 15.

There are three safe harbor approaches for employers to assess affordability: 1) The Federal Poverty Line Safe Harbor, 2) The Rate of Pay Safe Harbor, and 3) The Form W-2 Safe Harbor. For more details on how to determine whether a plan meets an affordability safe harbor, [see Slide 10 of the ACA Potluck webinar](#).

An applicable large employer that fails to offer affordable coverage (or fails to offer coverage that provides minimum value) is subject to potential pay or play penalties under IRC §4980H(b) (the "B penalty"). The 2016 B penalty liability would generally be \$3,240 annualized (\$270/month) multiplied by each such full-time employee who enrolls in subsidized coverage on the exchange. For more details on the §4980H pay or play penalties, [see Slide 15 of the ACA Potluck webinar](#).

### General Rule: Add Opt-Out Credit Amount to Cost of Plan in Determining Affordability

An opt-out credit for this purpose is a taxable payment to employees who decline to enroll in the major medical plan. As of the first plan year beginning on or after January 1, 2017, the amount of the opt-out credit must be added to the employee-share of the cheapest plan option providing minimum value that is used to determine affordability.

**Example:** The employee-share of the premium for the employer's cheapest plan option providing minimum value is \$75 per month for employee-only coverage if they elect to enroll. The plan offers a \$25 per month opt-out credit through the Section 125 cafeteria plan for employees who decline enrollment.

**Pre-2017 Result:** The plan's \$75/month lowest-cost option meets the Federal Poverty Line affordability safe harbor because it is within \$95.63 (9.66% of the 2016 Federal Poverty Line in the continental U.S).

**2017 Result:** The plan does not meet the Federal Poverty Line affordability safe harbor because you must add the lowest-cost plan option (\$75/month) to the opt-out credit (\$25/month) for a total cost of \$100/month (which exceeds \$95.63/month). The plan would need to meet an alternative safe harbor to remain affordable.

The IRS rationale for this increase to the affordability cost of the plan for opt-out credits is based on its view of the "economic cost" to the employee. In the example above, an employee who enrolls in the plan must not only pay \$75/month for the plan, they will also forgo \$25/month in opt-out credits. The IRS therefore views the employee's economic cost for enrolling in the plan to be \$100/month. This economic cost



approach accounts both for the plan cost the employee must pay (\$75) and the opt-out credit payment the employee must forgo (\$25) to enroll.

### **Exception: Conditioning Opt-Out Credit on Enrollment in Other Group Coverage**

Fortunately, the proposed regulations offer an exception to the general rule above that avoids the need to add the opt-out credit amount to the cost of the plan. This exception applies to an opt-out credit that meets the new IRS definition of an “eligible opt-out arrangement.”

An “eligible opt-out arrangement” must meet the following two requirements to qualify:

- 1) *The opt-out credit is conditioned on the employee declining to enroll in the major medical plan; and*
- 2) *The opt-out credit is conditioned on the employee providing reasonable evidence (including an employee attestation) annually that the employee and all members of the “employee’s expected tax family” have or will have minimum essential coverage under a group health plan during the period of coverage to which the opt-out credit applies.*

The “employee’s expected tax family” includes all individuals for whom the employee reasonably expects to claim a personal exemption deduction for the taxable year(s) in the plan year to which the opt-out credit applies.

For example, if an employee’s expected tax family consists of the employee, the employee’s spouse, and two children, the opt-out credit would meet the second requirement by requiring the employee to provide reasonable evidence that all four individuals in the family will have major medical coverage under the group health plan of the spouse’s employer for the period to which the opt-out credit applies. The employee’s attestation is sufficient as reasonable evidence for this purpose. Actual proof of other group coverage is permitted but not required to meet the eligible opt-out credit arrangement standard.

Keep in mind that this eligible opt-out arrangement will apply only if the employee and family have coverage under another group major medical plan. Coverage under an individual policy (including through the exchange) does not qualify.

Furthermore, the IRS cautions that conditioning an opt-out credit on an employee obtaining individual policy coverage could trigger the \$100/day §4980D penalties for reimbursing individual market coverage. For more details on the ACA individual policy reimbursement prohibition rules, [see Slides 6-8 of the ACA Potluck webinar](#) and our [previous alert](#).

**Bottom Line:** Employers with opt-out credits should consider modifying their approach for plan years beginning on or after January 1, 2017 to meet the “eligible opt-out arrangement” exception from the ACA pay or play affordability calculation to avoid potential penalties under §4980(b) (the B penalty).

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