

Opt-Out Payments and Health Coverage Affordability Issues

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Beginning this year in 2015, the Patient Protection and Affordable Care Act's Employer Shared Responsibility Provisions under Internal Revenue Code ("Code") Section 4980H (often referred to as the "Employer Mandate" or the "Pay-or-Play Rules") took effect, requiring an "applicable large employer" to either offer certain health coverage to its full-time employees ("play") or pay a tax to the IRS ("pay"). See our [February 2014 article](#) for a description of the Pay-or-Play Rules which, generally, provide that an "applicable large employer" may be subject penalties if the employer:

- Fails to offer the opportunity to enroll in "minimum essential coverage" (e.g., certain employer-sponsored health coverage) to "substantially all" (70% for 2015, 95% for 2016 and thereafter) of its full-time employees and their dependents, and at least one of its full-time employees purchases coverage through a State or Federal Exchange (i.e., the "Marketplace") with a premium tax credit (the "A" penalty); or
- Offers "substantially all" of its full-time employees and their dependent children the opportunity to enroll in minimum essential coverage, but the coverage is either not "affordable" or does not provide "minimum value," and the affected full-time employee purchases Marketplace coverage with a premium tax credit (the "B" penalty).

For purposes of the B penalty, the coverage offered by an employer is "affordable" if the employee's "required contribution" for the lowest cost self-only coverage that provides minimum value does not exceed a specified percentage (9.56% in 2015) of his or her annual household income. Most employers, however, are generally unaware of an employee's household income, so the Pay-or-Play Rules provide that an employer may determine affordability using one of the three optional safe harbors that use information accessible by the employer: (1) the "Form W-2 Safe Harbor," (2) the "Rate of Pay Safe Harbor," or (3) the "Federal Poverty Line Safe Harbor." (The safe harbors use a 9.5% threshold and have not been indexed to 9.56%.)

To many employers and practitioners, an employee's "required contribution" for purposes of determining affordability under the B penalty would seem to be equal to the employee's share of the premium for self-only health coverage. But, according to informal statements made by an IRS representative during an American Bar Association webinar on August 6, 2015 (expressing his own views and not necessarily those of the IRS), an employee's required contribution for these purposes also includes any cash payments or cafeteria-plan flex credits that are provided to the employee if he or she declines such health coverage (commonly referred to as "opt-out payments" or "opt-out credits").

For example, assume that an employer is using the Form W-2 Safe Harbor which generally provides that coverage is affordable if the employee's required contribution does not exceed 9.5% of that employee's Form W-2 wages for the calendar year. If the employee's Form W-2 wages for the calendar year are \$30,000, then, for the employer to satisfy the Form W-2 Safe Harbor, the employee's required contribution may not exceed \$237.50 per month ($\$30,000 \times 9.5\% / 12$). So, if the employee-only premium for the lowest cost self-only coverage is \$200 per month, then the employer has met the Form W-2 Safe Harbor for the employee. But, if employer also offers the employee a \$50-per-month payment if he or she declines major-medical coverage, then the employee's required contribution, according to the informal IRS statements, is actually \$250 per month (not \$200) — greater than the Form W-2 Safe Harbor amount.

Employers who are subject to the Pay-or-Play Rules and offer opt-out payments to employees may find the above method for determining affordability — which is not explicitly stated in any regulation or FAQ, but is nonetheless consistent with similar rules that are used to determine an individual's eligibility for a premium tax credit under Code Section 36(B) — to be an unwelcome surprise. To be safe, an employer may wish to include the amount of any opt-out payment in its determination of the "affordability" of the coverage it offers, per this informal IRS guidance.

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