

CLIENT NEWS BRIEF

IRS Issues Proposed Regulations Regarding Opt-Out Payments and the Affordable Care Act

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The Internal Revenue Service (IRS) released proposed regulations on July 8, 2016 that would require employers to include the dollar value of opt-out payments as part of an employee's required medical benefit premium cost contribution when calculating affordability of health care coverage under the Affordable Care Act (ACA). The IRS treatment of opt-out arrangements impacts the employer mandate to provide affordable health care through the ACA.

Pursuant to the employer mandate of the ACA, if an employee's required contribution toward medical premium costs exceeds a specified percentage of an employee's household income, an employer may be subject to penalties. As we reported earlier this year, the IRS issued Notice 2015-87 (Notice) on December 29, 2015. ([See 2016 Client News Brief No. 28.](#)) The notice provided guidance on how various health care coverage models will be treated for purposes of determining an employee's required contribution towards the cost of self-only employer-sponsored medical benefit coverage.

Opt-Out Payments: IRS Requires Value of Non-Eligible Opt-Out Payments to be Added to Cost of Employee's Contribution in Affordability Calculation Formula

Opt-out arrangements were addressed in the notice. The notice distinguished between (1) unconditional opt-out arrangements (i.e., where a payment is provided to an employee solely because the employee declined coverage) and (2) conditional opt-out arrangements (i.e., where a payment is conditioned on an employee satisfying a meaningful requirement in addition to declining coverage). The proposed regulations reframe this distinction. Under the proposed regulations, employers are required to include the amount of an opt-out payment in the affordability formula calculating an employee's required contribution for purposes of the employer mandate regardless of whether the employee actually receives the opt-out payment, unless the arrangement qualifies as an "eligible opt-out arrangement."

For example, consider an employer that offers its employees a \$50 per month opt-out payment for declining health care coverage that would otherwise cost employees at least \$200 per month for self-only coverage. Under the proposed regulations, the employer would combine the value of the opt-out payment with the cost of coverage and report the monthly required employee contribution as \$250 per month unless the opt-out payment was made pursuant to an eligible opt-out arrangement.

Eligible Opt-Out Arrangements

In order to qualify as an eligible opt-out arrangement, the arrangement must provide all of the following:

1. The employee's right to receive the opt-out payment must depend on:



Karen M. Rezendes
Partner

Walnut Creek Office
krezendes@lozanosmith.com



Niki Nabavi Nouri
Associate

Walnut Creek Office
nnabavinouri@lozanosmith.com



As the information contained herein is necessarily general, its application to a particular set of facts and circumstances may vary. For this reason, this News Brief does not constitute legal advice. We recommend that you consult with your counsel prior to acting on the information contained herein.

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- a. The employee declining to enroll in the employer-sponsored coverage; and
 - b. The employee providing reasonable evidence of alternative minimum essential coverage (other than coverage in the individual health-care coverage market) for the employee and the employee's expected tax family. Having an employee attest in writing may qualify as reasonable evidence of alternative coverage.
2. An opt-out payment will not be made if the employer knows or has reason to know that the employee or any member of the employee's expected tax family does not have or will not have the alternative coverage;
 3. Evidence of the alternative coverage must be provided no less frequently than every plan year to which the eligible opt-out arrangement applies; and
 4. Employees must provide evidence of the alternative coverage no earlier than a reasonable period of time before the commencement of the period of coverage to which the eligible opt-out arrangement applies.

For purposes of the employer mandate, the proposed regulations regarding opt-out arrangements are expected to be applicable for plan years beginning on or after January 1, 2017, as long as the opt-out arrangement was in place on or before December 16, 2015.

Collective Bargaining Agreement Opt-Out Provisions

The proposed regulations also clarify that an opt-out arrangement required under the terms of a collective bargaining agreement in effect before December 16, 2015 will be treated as having been adopted prior to December 16, 2015. Further, an employer party to such a collective bargaining agreement is not required to add the amount of an opt-out payment to the employee's required contribution when applying the affordability calculation until the later of: (1) the beginning of the first plan year that begins following the expiration of the collective bargaining agreement in effect before December 16, 2015 (disregarding any extensions on or after December 16, 2015) or (2) the applicability date of the regulations (currently anticipated to be January 1, 2017).

Section 125 Plans

Note that the proposed regulations also provide an exception for employer contributions to a section 125 plan that can be used by the employee to purchase minimum essential coverage. The IRS does not consider these payments "opt-out payments," regardless of whether the employee may receive the amount as a taxable benefit. However, please note that employer contributions to a section 125 plan may also impact affordability if the plan is not structured as a ["health flex contribution."](#)

In light of these proposed regulations, employers with opt-out arrangements should review their arrangements for relief eligibility and/or potential impacts on the affordability of employer-sponsored health care coverage.

For a discussion of how opt-out payments may also impact the regular rate of pay for overtime purposes under the Fair Labor Standards Act (FLSA), please refer to our prior Client News Brief regarding the Ninth Circuit Court of Appeals' decision in *Flores v. City of San Gabriel* (9th Cir., June 2, 2016, No. 14-56421) __ F.3d __ [2016 U.S. App. LEXIS 10008]. ([See 2016 Client News Brief No. 47.](#))

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For further information regarding the treatment of opt-out arrangements, please contact the authors of this Client News Brief or an attorney at one of our [nine offices](#) located statewide. You can also visit our [website](#), follow us on [Facebook](#) or [Twitter](#) or download our [Client News Brief App](#).

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