

# IMPACT OF FLEX CONTRIBUTIONS AND OPT-OUT PAYMENT ON AFFORDABILITY

White Paper

On December 17, 2015, the Internal Revenue Service (IRS) issued Notice 2015-87 providing further guidance on the application of various provisions of the Patient Protection and Affordable Care Act (ACA), and providing much anticipated information to employers that offer flex contributions to a Section 125 Plan, and to employers that offer opt-out payment to employees who decline major medical coverage.

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Penalties under the ACA's Employer Mandate may apply to an employer when a full-time employee qualifies for and receives financial assistance to purchase coverage on the marketplace, and the coverage offered by the employer to that full-time employee is not affordable because the employee's required contribution to the cost of coverage exceeds 9.5% (adjusted yearly for inflation) of the employee's household income.

Notice 2015-87 explains more about how exactly the IRS plans to calculate the employee's "required contribution" for purposes of assessing the affordability of employer-sponsored coverage. Bottom line: unless contributions meet specified guidelines, the employer may not receive credit when the IRS calculates affordability. The good news is that the IRS also announced transition relief which will delay enforcement of the new rules as long as the employer's contribution plan was already in place when the regulations were announced. Following is a summary of the new guidance:

## Employer Flex Contributions

### What Types of Employer Flex Contributions Will Count Toward the Required Contribution?

Under the new guidance, employer flex contributions which qualify as "health flex contributions" will reduce the amount of the employee's required contribution- and be applied in the employer's favor when calculating affordability-if the employer contribution meets **all** of the following criteria:

- The employee may not opt to receive the amount as a taxable benefit **AND**
- The employee must be able to use the amount toward the purchase of ACA qualifying medical coverage **AND**
- The employee can only use the amount to purchase medical care (including qualifying dental and vision) as defined by Internal Revenue Code (IRC) section 213

### What Types of Employer Flex Contributions Won't Count Toward the Required Contribution?

Any employer flex contribution which does not meet all three requirements is not a "health flex contribution" and will not reduce the amount of the employee's required contribution. Any of the following circumstances mean that the employer will not receive credit for the flex contribution when the IRS calculates affordability:

- The employee can choose to receive cash instead of purchasing benefits **OR**
- The employee is not permitted to apply the contribution toward the cost of ACA qualifying employer sponsored coverage ("minimum essential coverage") **OR**
- The employee can use the contribution to pay for non-medical care benefits such as dependent care or life insurance

### Is There Transition Relief for the 2015 and 2016 Plan Years?

Yes. For plan years beginning before January 1, 2017, if the amount of the flex contribution is available to the employee to pay for health coverage, it will count toward reducing the employee's required contribution as long as the employer qualifies for the transition relief. To qualify, the contribution arrangement has to have been in place prior to the release of the Notice. For example, relief is not available to a flex contribution arrangement offering non-medical care benefits that is adopted after December 16, 2015. Employers wishing to utilize transition relief should take care not to substantially increase the amount of the flex contributions offered to employees, as a substantial increase to the amount of the flex contributions that occurs after December 16, 2015 will make the employer ineligible for the relief.

## Opt-Out Payment

### When Will Opt-Out Payments Increase the Employee's Required Contribution?

The new guidance also addresses cash payments that are only available to employees if they decline medical coverage. Such payments are often referred to as "opt-out cash" or "cash-in-lieu." In the IRS' view, if any employee must give up a cash payment in order to enroll in the employer sponsored coverage, enrolling in coverage "costs" the employee, and the amount of the cash given up to enroll in the plan must be added to calculate the employee's required contribution. This has the effect of increasing the employee's required contribution by the amount of the opt-out payment, in effect penalizing employers for having an opt-out payment policy.

As an example, an employee with \$200/month premium payment who gives up the chance to receive \$50/month in opt-out payment actually has a required contribution of \$250/month.

The following types of opt-out payments must be added to the contribution paid by the employee when calculating the employee's required contribution:

- The amount cannot be used to pay for coverage under the employer's plan **AND**
- The amount is available only if the employee declines coverage

### **What if An Employer Attaches Conditions to the Opt-Out Payment?**

Some employers require employees to meet certain conditions in order to receive opt-out payments. Examples might include requiring employees that opt-out to demonstrate coverage under another group health plan, such as spouse's plan, in order to receive the payment. The guidance indicates that the IRS may treat such conditions differently in future guidance. The Notice states that the IRS intends to propose additional regulations.

### **Is Transition Relief Available for the 2015 and 2016 Plan Years?**

Yes. Until future guidance is released, and at minimum for plan year beginning before January 1, 2017, in calculating affordability, employers are not required to increase the amount of an employee's required contribution by the amount of an opt-out payment, and an opt-out payment will not be treated as increasing an employee's required contribution for purposes of penalties under the Employer Mandate. The opt-out arrangement must have been adopted by December 16, 2015. Opt-out arrangements adopted after December 16, 2015 are not eligible for the transition relief.

### **What does this mean for 2015 Employer Reporting under IRC section 6056?**

In most cases, employers offering flex contributions or opt-out payment arrangements adopted for plan years prior to January 1, 2017 will be able to rely on transitional relief in preparing their 2015 IRS reports. Employers are advised to review the requirements for the transition relief with tax or legal counsel to confirm their eligibility.

Employers that take advantage of the transition relief offered under Notice 2015-97 to report a lower amount as the employee's required contribution on the 2015 IRS reports (Form 1095-C) issued to employees and filed with the IRS in early 2016 are encouraged to notify employees that their required contribution may be higher if calculated without reliance on the transitional guidance. If the employee's modified required contribution is higher absent transition relief, the employee may still be eligible for a premium tax credit regardless of the required contribution or qualifying offer information reported on the employee's Form 1095-C.

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## **Caution:**

*American Fidelity Administrative Services does not provide tax or legal advice, and we always recommend working with your own legal counsel to discuss how your plans could be affected by these rules.*

*Further, this is only a brief summary that reflects our current understanding of select provisions of the law, often in the absence of regulations. All of the interpretations contained herein are subject to change as the appropriate agencies publish additional guidance.*



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