



Special Report

Commentary on Education Issues

IRS Guidance on Cash Options and Opt-Out Payments for ACA Affordability Determinations for Large Employers

****Special thanks to Mark Becker, Keri Farrell-Kolb, and Susan Pinckney, Benefit Compliance Program, for their development of this document. The Benefit Compliance Program is an IASB endorsed program. The program provides training, automatic updates, one-on-one consultations, and numerous other resources to guide subscribers through the processes and procedures required by benefit laws.***

[Note: This Special Report addresses specific concerns under the Affordable Care Act (ACA) for large employers (those with at least 50 full-time employees including an equivalent for part-time employees). If your district is not a large employer for ACA purposes, you do not need to be concerned with the ACA issues discussed in this update. However, even if your district is not a large employer, if you offer cash options, such as employer contributions to a cafeteria plan that may be taken in cash or opt-out payments for employees who waive health coverage, there are still potential compliance and plan performance concerns that should be discussed with your benefit consultant.]

Background

Recently, the IRS issued [Notice 2015-87](#) which provides guidance on several issues under the Affordable Care Act (ACA), including how cash options and opt-out payments will impact the ACA affordability calculation.¹ Last year, we issued a [Special Report](#) addressing potential concerns with offering cash options and opt-out payments for purposes of the ACA affordability requirement imposed on health plan coverage offered by large employers. IRS Notice 2015-87 validates the concerns we expressed in the prior *Special Report*.

Under ACA, large districts (those with at least 50 full-time employees, including an equivalent for part-time employees), must offer health plan coverage to full-time employees in order to avoid penalties. In addition, the coverage offered must provide minimum value and meet an affordability requirement. An employee's coverage is considered affordable if the employee is not required to pay more than 9.56%² of their income toward the cost of single coverage. The penalty for offering unaffordable coverage is \$3,240 for 2016³ per full-time employee who purchases coverage through the exchange and receives a premium tax credit. Thus, offering unaffordable coverage, particularly to large groups of employees, may result in significant penalties.

As you read through this *Special Report*, it is important to keep in mind the following:

- If your district does not: (1) contribute to a cafeteria (flex) plan in which employees can elect to receive flex contributions in cash or to pay for other non-health benefits, or (2) offer opt-out payments for employees who waive health coverage, then you do not need to do anything.

¹ IRS Notice 2015-87, Q&As 8 & 9 deal specifically with the impact of employer contributions to a flex plan and opt-out payments, respectively, on ACA affordability determinations.

² IRS Notice 2015-87, Q&A 12. The IRS announced that the affordability safe harbor percentage will be adjusted to be consistent with the percentage used under the individual mandate, so that employers may use 9.56% for plan years beginning in 2015 and 9.66% for plan years beginning in 2016.

³ IRS Notice 2015-87, Q&A 13. The IRS announced increased penalties from the original \$3,000 to \$3,120 for calendar year 2015 and \$3,240 for calendar year 2016.

- If your district does either or both of the above, you should review the applicable sections of this report and consult with legal counsel and your benefits consultant to determine what, if any, changes need to be made and the appropriate timing for making those changes.

District Contributions to a Flex Plan

Here is what we know now from the most recent IRS guidance:

- I. District contributions to a flex plan (“flex credits”) that can be taken in cash, or as another taxable benefit, or that can be used to pay for non-health benefits do not reduce the employee’s required health plan contribution for ACA purposes.

Example 1: The district makes a \$500 per month contribution to the flex plan that may be used to pay for any benefit offered under the flex plan, including medical and other non-health benefits (such as dependent care, life insurance, etc.) and/or may be taken as cash. Employees pay \$400 per month for single health plan coverage. Since the district contribution can be taken in cash or used to pay for non-health benefits, the district contribution in this case does not reduce the required employee health plan contribution. As a result, employees will be treated as paying the full \$400 per month for health coverage even if they use the flex credits to offset their cost. In this example, even if the flex credits may not be taken in cash, the fact that they may be used for non-health benefits results in the employee paying the full \$400 per month for health coverage.

Note: The same result will apply if the district gives employees a choice to apply all or a portion of cashed out flex credits toward a 403(b) arrangement also known as a tax sheltered annuity or (TSA).⁴

Effective Date of Guidance on Flex Credits: Notice 2015-87 provides transition relief for plan years beginning before January 1, 2017, which would include both the 2015-16 and 2016-17 plan years for most districts.⁵ During the transition relief period, for purposes of both the Employer Shared Responsibility rules and the related Internal Revenue Code Section 6056 reporting requirements, any flex contribution that may be used towards both health and non-health benefits (including cash) will be treated as reducing an employee’s required contribution.

Thus, in the example above, the district may report \$0 on line 15, Form 1095-C (or enter code 1A on line 14 with line 15 blank) for the transition relief period, assuming the district qualifies for the transition relief (see footnote #5 for districts that will not qualify for the relief). However, the IRS is encouraging employers to report as though the flex contribution did not reduce the employee’s required contribution so that employees may be eligible for premium tax credits during the transition period. In the example above, the district could report \$400 on line 15 instead of \$0 (in that case, the district could not enter code 1A on line 14). If a district disregards the flex contribution when reporting, and the IRS contacts a district regarding an employee that

⁴ Although a 403(b) arrangement cannot be offered as a benefit under a flex plan, it is possible for employees to receive flex credits in cash and, under a separate election outside the flex plan, apply the cashed out credits to a 403(b). However, since the cash option must be available under the flex plan in order to do this, the 403(b) option outside the flex plan does not change the result that the flex credits will not reduce the employee’s required health plan contribution for the ACA affordability determination.

⁵ This relief is not available for districts that adopt flex contribution arrangements offering non-health benefits after December 16, 2015 (i.e., a district starts making flex contributions that may be used for non-health benefits after Dec. 16, 2015 without a similar arrangement in place as of Dec. 16, 2015, unless the arrangement was approved by the school board or a committee before Dec. 16, 2015), or that substantially increase the amount of flex contributions after December 16, 2015.

received a premium tax credit, the district will have the opportunity to show it qualified for the transition relief.

- II. District contributions to a flex plan that meet the following requirements are treated as employer contributions and will reduce the employee's required health plan contribution for ACA purposes:
- The employee does not have the option to take the district contribution in cash or as another taxable benefit,
 - The contribution may be used to purchase group health plan coverage, and
 - The contribution may only be used to pay for medical care.⁶

Example 2: The district contributes \$500 per month to the flex plan. The district contribution may only be used to pay for coverage under the medical plan or contributed to a health flexible spending arrangement (health FSA). Employees pay \$400 per month for single health plan coverage. In this example, the \$500 flex credit is treated as an employer contribution which reduces the required employee contribution to \$0 regardless of whether the employee actually elects health plan coverage. Form 1095-C, line 15 should reflect \$0 for this situation (or be left blank if code 1A is used on line 14).

Example 3: The district contributes \$500 per month to the flex plan, and employees pay \$400 per month for single health plan coverage. Employees are required to purchase single health plan coverage, but may use the difference between the employer flex credit and the cost of single coverage (\$100) to pay for other benefits under the plan or to receive cash. This example may provide a solution for the district to meet the affordability requirement by removing the cash option and other non-health plan options for the portion of the flex credit that is needed to purchase single health plan coverage. By removing the cash option for the single premium, the \$400 flex credit would be treated as an employer contribution that reduces the employee contribution to \$0.

Opt-Out Payments

Payments that are only available if an employee waives or declines coverage are known as opt-out payments. The most recent IRS guidance on opt-out payments is limited to the following:

- I. "Unconditional" opt-out payments - payments that are not conditioned on any requirement other than to waive coverage - must be added to the employee's required health plan contribution. Opt-out payments that are conditioned on a requirement to provide proof of other coverage through a spouse's employer are treated as "conditional" opt-out payments which are discussed in Section II below.

Example 4: The district pays for single coverage, but employees who waive coverage receive \$200 per month (without a condition to provide proof of other coverage). In this example, the employee's required contribution for single coverage is \$200 per month. The IRS reasons that employees have to forgo receiving \$200 per month in order to elect coverage, so the opt-out payment has the economic effect of increasing the employee's contribution to \$200 per month.

Example 5: The district pays for all but \$100 toward single coverage, and employees who waive coverage receive \$200. In this example, the employee's required contribution for single coverage is \$300.

⁶ IRS Notice 2015-87, Q&A 8

- II. “Conditional” opt-out payments - employees are required to provide proof of other coverage in order to receive the payment – will be addressed in future regulations. The lack of guidance on conditional opt-out payments is troublesome since these types of opt-out payments are the most common. If it is any indication as to how the IRS is leaning, for purposes of the individual mandate, employees may add opt-out payments (both conditional and unconditional) to the cost of coverage when determining whether they will qualify for premium tax credits for coverage purchased through the exchange.

Effective Date of Guidance on Opt-Out Payments: Until regulations are issued, districts are not required to add opt-out payments (conditional or unconditional) to employees’ health plan contributions. The only exception is if a district adopts an unconditional opt-out arrangement after December 16, 2015, then payments under the arrangement must be added to the employee cost.⁷

Similar to the guidance on flex credits, the IRS has stated that an employer may add the opt-out payment to the employee contribution on line 15, Form 1095-C so that employees may qualify for premium tax credits. However, doing so will not result in an employer penalty if the coverage offered otherwise meets the affordability requirement without taking into account the opt-out payment, and districts will have the opportunity to show they qualify for transition relief, if necessary to avoid the employer penalties.

Conclusion

Despite the fact that it may take some time for the IRS to go through the regulatory process before we know for sure how opt-out payments will be treated and before the rules become effective, given the most recent guidance, districts that offer opt-out payments should consider eliminating such practices. In addition, districts that offer flex credits that can be used to purchase non-health benefits or that can be taken in cash, may need to revise those arrangements to meet the compliance requirements in order to avoid ACA penalties.

It is important to note that the guidance received so far has not provided special consideration for plans that are subject to a bargaining agreement, so districts will need to consider the timing of those agreements along with the effective date of the new rules. Given bargaining considerations, it may take time for districts to implement the necessary changes.

Please Note - This publication is designed to provide accurate and authoritative information about the subject matter covered. It is furnished with the understanding that IASB is not engaged in rendering legal or other professional service. In addition, the Benefit Compliance Program is not engaged in providing legal or tax advice. If legal advice or other expert assistance is required, the services of a competent professional person should be sought.

©Copyright 2016 – Iowa Association of School Boards
©Copyright 2016 - Benefit Compliance Program.
All Rights Reserved

⁷ IRS Notice 2015-87, Q&A 9. An opt-out arrangement will be treated as adopted after Dec. 16, 2015 unless (1) the district offered the opt-out arrangement (or a substantially similar one) for a plan year including Dec. 16, 2015; a board or committee specifically adopted the opt-out arrangement prior to Dec. 16, 2015; or (3) the district provided written communication to employees on or before Dec. 16, 2015 indicating that an opt-out arrangement would be offered at some time in the future.

**Summary of IRS Guidance:
Impact of District Contributions to a Flex Plan and Opt-Out Payments
on ACA Affordability Determinations**

District Offers:	ACA Impact on District	ACA Impact on Employees
Flex Credits - District contributions to Section 125 plan that may be used to purchase non-health benefits or may be taken in cash	Flex credits do not reduce the employee's required contribution for health coverage; may result in unaffordable coverage under ACA (See Example 1 in Special Report)	Flex credits do not reduce any required employee contribution for health coverage. Employees may qualify for premium tax credits and trigger a district penalty if coverage is not affordable (See Example 1 in Special Report)
Flex Credits - District contributions to Section 125 plan that may be used only to purchase health benefits	Flex credits are treated as a district contribution that may reduce the employee's required contribution for health coverage; credits have a positive impact on the affordability calculation for the district (See Example 2 in Special Report)	Flex credits reduce any required employee contribution for health coverage (See Example 2 in Special Report)
403(b) Contribution - District offers employees the choice to contribute cashed out flex credit to 403(b) plan	Same result as flex credits that may be taken as cash (See Note under Example 1 in Special Report)	Same result as flex credits that may be taken as cash
Opt-Out Payment - Unconditional (payment not conditioned on showing proof of other coverage)	Add opt-out payment to employee cost of health coverage (See Examples 4 & 5 in Special Report)	Add opt-out payment to employee cost of health coverage which may allow employees to qualify for premium tax credits if coverage is unaffordable and exchange coverage is purchased
Opt-Out Payment - Conditional (payment conditioned on showing proof of other coverage)	Uncertain until IRS issues regulations (See discussion in Special Report under " Opt-Out Payments ", Section II)	Add opt-out payment to employee cost of health coverage which may allow employees to qualify for premium tax credits if coverage is then unaffordable and exchange coverage is purchased