AssuredPartners

Opt-Out Incentives (Cash-in-Lieu of Benefits)

April 2024

Some employers choose to offer an opt-out incentive or cash-in-lieu of benefits for eligible employees and their family members who waive the benefits offered by the employer. For example, the employer may offer a monthly cash incentive to those who waive the employer's offer of medical coverage. In some cases, the employer may use this as a strategy to encourage individuals not to enroll in the employer's benefits, potentially reducing the plan's claims exposure. In other cases, the employer may be looking for ways to provide additional benefits to those employees who have coverage options available elsewhere. In either case, such incentives are generally permitted subject to any carrier restrictions, but there are several compliance factors to consider when determining the design as outlined below.

Carrier Restrictions

Any opt-out incentive should be discussed with the carrier because some carriers have their own restrictions around such practices (e.g., to maintain participation levels).

Types of Incentives

Taxable Cash

Most commonly, the incentive is provided as cash. The cash provided should be treated as additional taxable compensation and must be included in the employer's cafeteria plan to avoid issues of constructive receipt (which may have additional tax consequences). There is flexibility in how the cash is provided, concerning both amount and timing. Some employers choose to provide an incentive that is approximately the same amount as the employer contribution toward the coverage, whereas others choose to provide a much smaller incentive. Whatever the incentive amount, although it could be provided in a lump sum up front, it is safest to provide it as a per pay period or monthly incentive to avoid issues with employees who choose to enroll (e.g., due to a HIPAA special enrollment right) or who lose eligibility mid-year.

Tax-Favored Options

If there is a desire to provide the incentive on a tax-favored basis, it may be possible to provide the incentive as a health FSA, HRA or HSA contribution.

Health FSA

The health FSA contribution must be limited to the greater of $500 or a match of any employee contribution to maintain excepted benefit status and avoid violating healthcare reform requirements.

HRA

If the money is made available via HRA reimbursement, a general-purpose HRA must be integrated with another group health plan (i.e., made available solely to those enrolled in the other group health plan) to avoid violating healthcare reform requirements. For example, the employer could make the HRA available to those who prove enrollment in their spouse's employer's group health plan.

Alternatively, the employer could offer a limited-purpose HRA solely for dental and vision expenses that would not have to be integrated with another group health plan and would also avoid any issues with HSA-eligibility. A post-deductible HRA would also avoid any issues with HSA-eligibility.

HSA

An HSA contribution would be possible only for those who are HSA-eligible (i.e., enrolled in a qualifying HDHP with no other disqualifying coverage such as Medicare). It would also need to be offered through the employer's cafeteria plan to avoid violating comparability rules.

Eligible Individuals

There is flexibility to offer an opt-out incentive only to employees who waive the coverage, only for spouses and dependents who waive coverage, or a combination of the two. However, within the group who is eligible for the opt-out incentive, the employer should take the following compliance requirements into account.

Healthcare Reform Prohibits Paying for Individual Coverage

Current agency guidance prohibits employers from reimbursing employees for individual health insurance other than through an individual coverage HRA (ICHRA) or qualified small employer HRA (QSEHRA). Reimbursement of individual health plans, whether on a pre-tax or after-tax basis, creates a group health plan that will fail to satisfy various healthcare reform requirements. An employer offering such an arrangement could be subject to penalties of up to $100/day per affected individual. Therefore, the employer should not provide an opt-out incentive tied to proof of individual coverage.

HIPAA Nondiscrimination Rules

Employers are prohibited from incenting high claimant/high risk individuals to not enroll in the employer's group coverage. Such practice violates HIPAA's nondiscrimination rules that prohibit discrimination based on health factors. The argument is that such individuals pay more for the same coverage because they have to forego the additional cash in order to actually obtain coverage. The biggest risk to the employer is that the individual could come back and make a discrimination claim if issues with medical coverage should arise in the future. Therefore, the opt-out incentive should not be limited only to those who might be considered high risk/high claimants.

§125 Nondiscrimination Rules

As mentioned above, an opt-out incentive provided as cash must be run through the employer's cafeteria plan to avoid issues of constructive receipt because a choice is being given between a taxable and non-taxable benefit. In some cases, there may be a desire to offer the opt-out incentive only for certain plan options (e.g., 1 of 3 different medical plan options) or to a certain category of employees. Since the opt-out incentive must be included in the cafeteria plan, especially if the employer chooses to limit which plans or individuals are eligible for the opt-out incentive, it may be necessary to run discrimination testing to ensure that doing so doesn't cause the cafeteria plan to discriminate in favor of the highly compensated or key employees.

Government-Sponsored Coverage

For those enrolled in governmental coverage (e.g., Medicare, Medicaid, or TRICARE), requiring proof of coverage may be a problem; it's unclear.

Medicare Secondary Payer (MSP) rules require that Medicare eligible/enrolled individuals be offered the same benefits and not be incentivized not to take the employer's group health plan when the employer's group health plan is considered the primary payer. The employer's plan is the primary payer to age-based Medicare if the employer has 20 or more employees, and to disability-based Medicare if the employer has 100 or more employees. There is informal guidance indicating that so long as the incentive is available to all who waive, or all who show proof of other coverage, and not just to those providing proof of Medicare, it is okay. However, the current CMS MSP manual contradicts these informal comments, and therefore the conservative approach is to avoid providing the opt-out incentive to those eligible for or enrolled in Medicare.

Similarly, federal law prohibits employers from providing financial or other incentives for a TRICARE eligible employee not to enroll (or to terminate enrollment) under a health plan that would otherwise be primary to TRICARE. However, unlike the guidance from CMS for the MSP rules, guidance indicates an opt-out incentive for TRICARE participants is generally okay so long as it is not available only to those enrolled in TRICARE.

Affordability (Applicable Large Employers)

An applicable large employer (50 or more FTEs) must offer minimum value coverage to full-time employees that is "affordable" to avoid potential penalties under §4980H(b). When determining the employee contribution for medical coverage, IRS guidance indicates that the amount of an opt-out incentive is added to the employee contribution amount if the opt-out is unconditional (i.e., available to all who waive), but not if it meets the criteria for an eligible opt-out arrangement.

An "eligible opt-out arrangement" is one in which opt-out payments are available only to employees who:

- decline to enroll in the employer-sponsored coverage; and
- provide reasonable evidence that the employee and all other individuals in the employee's expected tax family "have or will have minimum essential coverage (other than coverage in the individual market) during the period of coverage to which the opt-out arrangement applies."

An arrangement would meet the definition of an eligible opt-out arrangement so long as the opt-out incentive is limited to those who indicate enrollment in other group health plan coverage or government-sponsored coverage (e.g., Medicare, Medicaid, TRICARE). The only clear exclusion is individual health coverage. Agency guidance

indicates an employee's attestation that the expected tax family has or will have minimum essential coverage is adequate; further proof is not required.

Example: Opt-Out Incentive & Affordability

The employee cost for single health coverage is $125 per month and a monthly cash opt-out incentive of $75 is provided if coverage is waived.

- If the opt-out incentive is available to any eligible employee who waives coverage (unconditional), the employee contribution for affordability purposes is $200 ($125 + $75).
- If the opt-out incentive is available only to eligible employees who waive coverage AND show proof of other group health coverage for their entire tax family under another employer's plan (an "eligible opt-out arrangement"), the employee contribution for affordability purposes is $125.

NOTE: For opt-out incentives in place prior to December 16, 2015, regardless of whether the opt-out is an eligible opt-out arrangement, there is transition relief so long as the program remains substantially the same. In other words, the incentive is not considered for purposes of the affordability calculation.

Summary

Employers may be interested in offering an opt-out incentive to encourage individuals not to enroll in employer-sponsored benefits or to compensate those who do not need the employer-sponsored coverage. Regardless of the intent, if the employer would like to provide such incentive, the employer should carefully consider the plan design to ensure it doesn't cause any issues with the carrier or with the various compliance requirements as discussed above.