

Spousal & Dependent Carve-Outs, Surcharges, and Incentives

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Background

As healthcare costs continue to rise, more and more employers are considering implementing eligibility carve-outs, premium surcharges, and other incentives to waive coverage as a strategy to reduce costs. Some employers may choose to completely exclude spouses and/or dependents from eligibility, but others take a less aggressive approach, excluding only certain spouses or dependents (e.g., those who are eligible for or enrolled in other group health coverage), or imposing surcharges for those who choose to enroll. In addition to attempts to reduce costs, other employers may be looking to offer more variety and flexibility in their plan offerings. For employees who do not need coverage for family members through the employer's plan, the employer can still provide value beyond the employee's normal compensation by providing an opt-out credit or spousal incentive HRA (SIHRA).

Although spousal carve-outs, surcharges, and incentives are generally allowed, such options for dependent coverage may violate requirements under the Affordable Care Act (ACA). For those considering making changes to spousal and/or dependent coverage, the design and administration of those changes should be considered carefully.

Federal Compliance Considerations

Spouses

Employers are not required to offer coverage to spouses. Employers choosing to offer coverage to spouses have the flexibility to impose a surcharge for those spouses who enroll, to provide an incentive to not enroll or to completely carve-out spousal eligibility without violating benefit compliance rules.

Dependent Children

Offering an incentive when coverage is waived for dependent children is likely okay, but imposing a dependent carve-out or surcharge is more challenging, and in many cases it may not be possible because of two separate requirements under the ACA.

§4980H – Employer Mandate

Although small employers (fewer than 50 FTEs) can choose to exclude dependents, applicable large employers (50 or more FTEs) must offer coverage to full-time employees and their dependent children to avoid §4980H penalties.

Coverage to Dependents until Age 26

In addition to §4980H requirements, the ACA requires employers of any size who choose to offer coverage to dependent children¹ to offer such coverage until age 26 without regard to tax dependency, residency, marital status, employment status, eligibility for other coverage, and/or student status. Therefore, making coverage for a dependent child conditional upon things such as marital status or enrollment in other coverage would violate this rule.

Imposing a surcharge could also be an issue depending on how the surcharge is structured. Imposing a surcharge only for certain dependent children (e.g., those who are married, those who have coverage through their own employment, or those who have coverage available through another parent) could be an issue under the ACA if the surcharge is tied in any way – even tangentially – to the age of the dependent. If the employer continues to make coverage available to dependent children and doesn't restrict any of the benefits, it may be possible to impose a surcharge as long as it is not based on age. However, if the surcharge applies only for those who have other job-based coverage or who are married, that is likely to be an issue since it would apply only to adult children.

Design and Administrative Considerations

Because carve-outs for dependent children are generally available only to small employers, and coverage surcharges for dependent children will typically pose an issue under ACA requirements for employers of all sizes, the design and administrative considerations outlined below focus on spousal carve-outs, incentives, and surcharges. In the context of a fully-insured plan, although surcharges and incentives are generally not issues, some carriers do not allow carve-outs.

Eligibility

An employer must first consider what form of eligibility rules it wishes to implement. There are four basic approaches beyond simply excluding all spouses, outlined below.

Scenario 1: Spousal Carve-Out (for those with other group health plan coverage)

With this approach, the employer defines plan eligibility so that spouses are ineligible to participate if they are eligible for other employer-sponsored coverage. The employer should decide whether eligibility will be affected by the type or cost of other coverage available. For example, will the spouse still be ineligible if their employer offers only a limited-medical (e.g., mini-med) plan, or if the other plan is significantly more expensive?

¹ Code §152(f)(1) defines “child” as “a son, daughter, stepson, or stepdaughter of the taxpayer, or...an eligible foster child of the taxpayer.” The plan is not required to include in the definition of a dependent those who fall outside the Code §152(f)(1) definition of “child,” such as the niece/nephew or grandchild of a legal guardian; and if the plan does choose to include those individuals in the definition, it may impose additional restrictions. See FAQ at <https://www.dol.gov/sites/default/files/ebsa/about-ebsa/our-activities/resource-center/faqs/aca-part-i.pdf> (Q/A #14).

Scenario 2: Spousal Surcharge (for those with other group health plan coverage)

Imposing a surcharge (i.e., a larger employee contribution) for spouses who are eligible for other employer-sponsored coverage provides an incentive for spouses who choose to enroll in the other coverage while still permitting eligibility in the employer's plan for those who need it. However, this approach may create an extra level of complexity in the communication and administration of benefits and payroll.

Scenario 3: Spousal Eligibility Restricted to When Other Coverage is Also Elected

Some employers define eligibility in such a way that if a spouse has other coverage available, the spouse must enroll in that coverage to be eligible for the plan. Allowing spouses to enroll in the plan only if they also enroll in other available coverage makes the employer's plan the secondary payer for claims. This strategy can reduce plan costs while still allowing spouses to enroll when necessary. Spouses are also less likely to enroll in the employer's plan if they already have other coverage.

Scenario 4: Spousal Incentive HRA (SIHRA)

Some employers offer an HRA as an incentive for employees and/or spouses to waive coverage and join the spouse's employer's plan. Employers can design the SIHRA so that it will only integrate with a spouse's employers' plan; limit the SIHRA so it's only available if the employee waives coverage on the employer's plan; or make it available even if the employee elects the group plan so that the employee is covered on the employer's plan and the spouse is covered on the spouse's employer's plan. Employers can limit the expenses eligible for reimbursement to cost sharing expenses on the spouse's plan or open it up to be able to be used for any §213(d) medical expenses. Employers should consider that the SIHRA will not work well alongside HDHPs because the SIHRA would cause HSA-ineligibility unless it is offered as a post-deductible HRA. In addition, SIHRAs must comply with other requirements applicable to HRAs such as ERISA plan document and Form 5500 filing requirements, COBRA continuation, PCORI fees and §6055 coverage reporting.

Scenario 5: Opt-Out Incentive ("Cash-In-Lieu of Benefits")²

Some employers choose to offer an opt-out incentive or cash-in-lieu of benefits for eligible employees who choose to 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. Employers can design an opt-out incentive to be available only if the employee waives coverage on the employer's plan; or it could be available when coverage is waived for spouses. Although such incentives are generally permitted (subject to any carrier restrictions), there are several things to consider when determining the design as outlined below.

NOTE: The above approaches assume that if all spouses are not completely excluded from coverage eligibility, that the carve-out, incentive or surcharge considers only coverage under another group health plan (e.g., through the spouse's employer). Tying the carve-out, incentive or surcharge to government-sponsored coverage such as Medicare, Medicaid or TRICARE is generally not permitted (e.g., such provisions would likely violate Medicare Secondary Payer (MSP) rules). In addition, tying an incentive to other individual coverage would violate health care reform requirements. See more details below.

Verification

When an employer imposes a spousal surcharge, incentive, or carve-out, it must decide how other coverage should be verified and must follow the process on a uniform basis for all employees with spouses who may be eligible for the plan. This is generally accomplished by use of an employee affidavit, by performing periodic eligibility audits, by requesting actual certification from the spouse's employer, or by some combination of these approaches. When making this decision, the employer must weigh time and cost considerations against the potential for plan savings. Also, if this involves a fully-insured plan, the carrier may have some requirements of its own. Each option is outlined in greater detail below.

Employee Affidavits:

The simplest, and perhaps most common, approach is to require a signed affidavit from the employee that certifies that the spouse is not eligible for other employer-sponsored coverage. The success of this approach depends on the employee's providing accurate information. Compliance can be increased by making it clear that significant consequences (e.g., loss of coverage and/or premium repayment) will result if inaccurate information is provided. An employer using this approach must consider and communicate whether certification upon enrollment will suffice for the plan year or whether the employee is expected to update the employer of any changes mid-plan year.

Eligibility Audits

Some employers perform periodic eligibility audits to ensure that only eligible individuals are enrolled in the plan coverage. In addition to reviewing spousal eligibility, these audits often review other issues, such as dependent eligibility.

Certification from Spouse's Employer

A few employers require the spouse to obtain from their employer a signed form or certification that provides the information necessary to make an eligibility determination. Although this approach ensures that the employee and/or spouse provides accurate information, it also increases the administrative burden on the employer and on employees. The spouse's employer is under no legal requirement to provide the information. If the spouse's employer refuses, the employee and spouse are put in a difficult position. In addition, the spouse's employer may be prohibited from providing plan enrollment information directly to another employer because of HIPAA privacy rules. To avoid this problem, the certification process should require that the spouse obtain the certification from their employer directly and then provide it to the plan.

Other Compliance Considerations

Medicare Secondary Payer (MSP) Rules

MSP rules, which apply to employers with 20 or more employees, require that employees and their spouses aged 65 or older be offered the same benefits as other employees and prohibit employers from incentivizing them not to take the employer's group health plan. In addition, similar rules apply to employers with 100 or more employees for disability-based Medicare. Making spouses ineligible or imposing a surcharge, if the spouse is eligible or enrolled in Medicare would violate these rules. Similarly, a SIHRA tied to proof of Medicare coverage would violate these rules. Specifically with respect to opt-out incentives, there is informal guidance indicating that so long as the additional cash (incentive) is available to all who show proof of other coverage and not just to those providing proof of Medicare, it is okay. That being the case, the current Centers for Medicare and Medicaid Services (CMS) MSP manual does not reflect and arguably 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.

Other Government Coverage

Just like for Medicare, employers are generally prohibited from tying a spousal carve-out, surcharge or SIHRA to TRICARE or Medicaid coverage. For an opt-out incentive, 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, informal 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. Medicaid requirements vary by state, but it is likely okay to provide an opt-out incentive to those who waive in favor of Medicaid so long as the opt-out incentive is not available solely to those who are eligible for or enrolled in Medicaid.

Applicable Large Employer (ALE) Affordability Issues

An applicable large employer (50 or more FTEs) must offer minimum value coverage to full-time employees that is considered "affordable" to avoid potential penalties under §4980H(b). When determining the employee contribution for the 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” (e.g., available only upon enrollment in other group health plan coverage). So, for example, consider an employee cost for single health coverage of \$125 per month and a monthly cash opt-out incentive of \$75 if coverage is waived. If the opt-out incentive is available to any eligible employee who waives coverage (unconditional), the employee contribution reported on Line 15 of Form 1095-C for affordability purposes is \$200 (\$125 + \$75). However, if the opt-out incentive is available only to eligible employees who waive coverage AND show proof of other group health coverage under another employer’s plan, the employee contribution for affordability purposes is \$125. NOTE: If the opt-out incentive is available solely for a waiver of spousal or dependent coverage (not available for an employee’s waiver of coverage), then the opt-out incentive will not impact the affordability of the offer to the employee for purposes of §4980H(b).

Health Reform Prohibits Paying for Individual Coverage

Current agency guidance prohibits employers from reimbursing employees for individual health insurance. 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 or SIHRA tied to proof of individual coverage.

COBRA

A spousal carve-out will not trigger COBRA continuation rights for spouses currently covered by the employer’s plan. Loss of eligibility that arises because of a plan change is not a COBRA qualifying event for the spouse. Although some employers may be tempted to offer COBRA in this situation, an insurance carrier or stop-loss provider might not provide coverage since it is not an actual COBRA event.

A SIHRA is a group health plan subject to federal COBRA continuation requirements. Upon a loss of coverage under the SIHRA triggered by a COBRA qualifying event (e.g., employee’s termination of employment or reduction of hours, employee’s death, or divorce), COBRA should be offered to any individuals who lost coverage under the SIHRA.

HIPAA Special Enrollment Rules

Employers should consider how their rules will affect the spouse’s ability to enroll in the spouse’s employer-sponsored plan, especially if the plans have different plan years. Loss of coverage triggers a HIPAA special enrollment, so in the case of loss of eligibility due to a spousal carve-out, HIPAA would require the spouses’ employer to permit the spouse to enroll in the plan mid-year. However, implementation of a surcharge, SIHRA or opt-out incentive does not trigger a HIPAA special enrollment and would not require the spouse’s employer to permit midyear enrollment unless the employer eliminates any employer contribution for spousal coverage (i.e., the employee pays 100%).

§125 Cafeteria Plan Issues

Employers should be aware that the spouse’s ability to make election changes in their employer-sponsored plan will depend on that plan’s definition of allowable status-change events. As described above, health plans are

required to allow mid-year election changes in the case of HIPAA special enrollment events; however, other §125 status changes are optional (e.g., change in cost of coverage) and can vary from plan to plan.

Grandfathered Plan Status

A spousal surcharge could affect a plan's grandfathered status under the ACA. To retain grandfathered status, an employer must refrain from reducing the percentage of premium paid by the employer by more than 5% for any tier of coverage from what the employer contributed on March 23, 2010. If the imposition of a surcharge reduces the employer contribution below that level, the plan would lose grandfathered status even if it only affects a small number of employees.

Interaction with State Laws

States may have conflicting laws that also must be considered. For example, a state's insurance law may define certain spousal or dependent coverage. In addition, some jurisdictions may have marital discrimination laws that could be interpreted to prohibit a spousal carve-out or surcharge. Although ERISA preemption may provide protection from such requirements for certain plans (e.g., self-funded plans subject to ERISA), employers should consult with legal counsel to make sure their strategy does not violate any state or local laws.

Plan Documentation

Employers that implement a spousal carve-out, incentive, SIHRA or surcharge must update plan document(s) and summary plan description(s) so that they reflect the new enrollment rules or options. Employers should also carefully and clearly describe the eligibility requirements, along with any verification procedures and potential consequences; they should also make sure to communicate these things to employees, generally as part of the enrollment process.

Summary

The cost benefits and potential impact on employee behavior or satisfaction of imposing a carve-out, surcharge, SIHRA or incentive will vary from employer to employer and might have a larger impact on self-funded plans. Using such strategies can be an effective way to reduce plan costs or offer a flexible benefit program, but employers should first carefully consider the different approaches and make sure compliance-related issues are properly addressed.

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