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IRS ISSUES PROPOSED REGULATIONS ON OPT-OUT PAYMENTS

Some municipalities offer a financial incentive to eligible employees who waive health coverage. Generally, these financial incentives are available to employees who have other coverage available through a spouse's employer.

On July 8, 2016, the IRS issued proposed regulations on opt-out payments. These proposed regulations generally provide that the amount of an opt-out payment increases the employee's required contribution for purposes of determining whether the coverage is affordable. Otherwise stated, if an employer offers an opt-out payment, it is more likely that the health plan will be deemed to be "unaffordable" under the Affordable Care Act. The affordability determination is important for municipalities with at least fifty full-time equivalent employees.

However, "eligible opt-out arrangements" are not included for purposes of the affordability test. The proposed regulations define an "eligible opt-out arrangement" as an arrangement under which the employee's right to receive the opt-out payment is conditioned on (1) the employee declining to enroll in the employer-sponsored coverage and (2) the employee providing reasonable evidence that the employee and his/her tax family have or will have minimum essential coverage (other than coverage in the individual market, whether or not obtained through the Marketplace) during the period of coverage to which the opt-out arrangement applies.

Reasonable evidence of alternative coverage (such as an attestation) must be provided no less frequently than annually. Notwithstanding any evidence of alternative coverage, the employer must not make an opt-out payment if the employer knows or has reason to know that the employee or any dependent will not have the alternative coverage.

If an opt-out payment is conditioned upon an employee obtaining individual market coverage, this opt-out arrangement may constitute an impermissible employer payment plan under the Affordable Care Act.

The regulations are proposed to apply for taxable years beginning after December 31, 2016. Special rules apply if the opt-out payments are required by a collective bargaining agreement. Final regulations will be published in the coming months.

Regardless of the applicability of the proposed regulations, municipalities utilizing opt-out payments should step back and re-examine the practice. First, employees will generally opt for coverage under a spouse's plan because it is a better plan, not as a result of the financial incentive. Second, opt-out payments offer an incentive that generally is not available to individuals who are not married.