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REVISED

Circular Letter

October 21, 2016

**TO: CALPERS PUBLIC AGENCIES, SCHOOLS, INDIVIDUAL SCHOOL DISTRICTS,
AND CALIFORNIA STATE UNIVERSITIES**

**SUBJECT: AFFORDABLE CARE ACT PROPOSED RULE REGARDING HEALTH PLAN OPT-
OUT PAYMENTS**

The purpose of this Circular Letter is to provide additional “opt-out” information to what was presented in [Circular Letter 600-038-16](#) for health benefit officers and other personnel staff. The Treasury Department and Internal Revenue Service (IRS) recently issued the proposed rule, “[Premium Tax Credit NPRM VI](#),” that among other things, discusses opt-out arrangements and their impact on an employee’s required contribution for purposes of determining the affordability of health coverage under the Affordable Care Act (ACA).¹

Regulations developed from the proposed rule are expected to be finalized before the end of 2016, and may become applicable as early as January 1, 2017. CalPERS’ contracting agencies and schools (CalPERS Employers) should carefully review the proposed rule to determine how they may be impacted. CalPERS staff continue to assess laws and regulations related to the ACA, which may affect CalPERS Employers. While we make every effort to assist CalPERS Employers, this Circular Letter is solely informational, current as of the date shown above, and general in nature. This Circular Letter should not be acted upon without specific legal advice. CalPERS encourages each CalPERS Employer to thoroughly review the Circular Letter, and the federal regulations and corresponding guidance discussed within, with its own legal counsel to understand how it might specifically apply to them.

Under the ACA, applicable large employers are required to offer affordable coverage that provides minimum value to their full-time employees or potentially pay penalties.² An employer-sponsored plan is generally considered affordable if the employee’s contribution does not exceed a certain percentage of that employee’s income.³ Accordingly, how an employee’s contribution is calculated is important.

¹ See the preamble to the proposed rule, § 2.f., for an overview of opt-out arrangements and an employee’s required contribution.

² See Shared Responsibility for Employers Regarding Health Coverage; Final rule <https://www.gpo.gov/fdsys/pkg/FR-2014-02-12/pdf/2014-03082.pdf>

³ See 26 U.S.C. §36B(c)(2)(C) and 26 C.F.R. §1.36B-2(c)(3)(v)(A)(1) and (2)

Building upon [Notice 2015-87](#), the proposed rule sets forth that the IRS will generally add opt-out payments (i.e., a payment an employer makes available to the employee only if the employee declines the employer's health coverage)⁴ to an employee's required contribution for health coverage (on Form 1095-C, line 15) unless the payment meets certain conditions.

Under the proposed rule, §1.36B-2(c)(3)(v)(A)(7) and §1.5000A-3(e)(3)(ii)(G)(1) specify that, in general, the amount of an opt-out payment will increase the employee's required contribution for purposes of affordability regardless of whether the employee enrolls or declines to enroll in employer-sponsored coverage and is paid the opt-out payment. When, however, the opt-out payment meets the proposed rule's definition of an "eligible opt-out arrangement," the payment would not increase the employee's required contribution for purposes of affordability regardless of whether the employee enrolls in the plan or is paid the opt-out payment.

An "eligible opt-out arrangement," under the proposed rule, generally means an arrangement under which an employee's right to receive an opt-out payment is conditioned on the employee providing reasonable evidence that the employee and all other individuals for whom the employee expects to claim a personal exemption deduction for the taxable year (the employee's "tax family") will have minimum essential coverage⁵ (e.g., coverage through a spouse's employer). Reasonable evidence of alternative coverage may include attestation.

Regardless of such evidence, an "eligible opt-out arrangement" must provide that the payment will not be made, and the employer must not make the payment, if the employer knows (or has reason to know) that the employee and his or her tax family do not, or will not, have alternative coverage. An employer with an "eligible opt-out arrangement" must also require evidence of applicable alternative coverage at least every plan year and should require such evidence no earlier than a reasonable time before the start of the coverage period (such as during open enrollment).⁶

The preamble to the proposed rule also clarifies that under Notice 2015-87, employers providing "unconditional opt-out arrangements"⁷ under collective bargaining agreements adopted prior to December 16, 2015, should not treat such payments as increasing the "unconditional" opt-out arrangement (i.e., a payment conditioned solely on an employee declining employer-sponsored health coverage and not on any other meaningful requirement, such as requiring the employee to prove coverage provided by a spouse's employer plan) in the same manner as a salary reduction for purposes of determining an employee's required contribution. In other words, the cash an employee foregoes in order to enroll in the large

⁴ See 26 C.F.R. §1.36B-2(c)(3)(v)(A)(7)(iii)(A) and §1.5000A-3(e)(3)(ii)(G)(3)(A) for the proposed rule's opt-out payment definitions.

⁵ Not including individual coverage, whether or not obtained through the health insurance Marketplace.

⁶ Provided that employers meet the reasonable evidence of coverage requirement, the "eligible opt-out arrangement" payment will generally continue to be excluded for the entire coverage period when calculating the employee's required contribution even if alternative coverage for the employee (or any member of his or her tax family) is terminated in the middle of the coverage period.

⁷ An arrangement, described in Notice 2015-87, providing for a payment conditioned solely on an employee declining coverage under an employer's health plan and not on an employee satisfying any other meaningful requirement related to the provision of health care, such as a requirement to provide proof of coverage provided by a spouse's employer.

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employer's health plan will not be added to the employee's required contribution for purposes of employees' required contributions until the latter of the start of the plan year that begins following the expiration of the agreement (disregarding any contract extensions on or after December 16, 2015), or the effective date of forthcoming final regulations.

In sum, CalPERS Employers that offer opt-out payments to employees should carefully review such arrangements in light of the proposed rules in order to avoid or minimize potential federal penalties for failure to offer affordable health coverage.

If you have any questions, please call our CalPERS Customer Contact Center at **888 CalPERS** (or **888-225-7377**).

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