

COMPLIANCE OVERVIEW

Health Plan Carve-outs, Surcharges and Incentives for Working Spouses

Employer-sponsored health plans typically offer coverage for employees' family members, including spouses. However, some employers implement special restrictions for working spouses to help reduce costs. These restrictions often take the form of:

- A **spousal carve-out**, which restricts or excludes eligibility for spouses with health coverage available through their own employers; or
- A **spousal surcharge**, which is an additional premium or contribution that employees must pay for covering spouses with health coverage available through their own employers.

In addition, employers may consider offering incentives, such as **taxable cash payments** or health reimbursement arrangement (HRA) coverage, to encourage employees to opt out of their health plan coverage and instead elect coverage through a spouse's employer. This type of HRA, which is called a **spousal incentive HRA**, reimburses cost-sharing amounts that are incurred under the spouse's employer's health plan, such as deductibles, on a tax-free basis.

LINKS AND RESOURCES

- [IRS FAQs](#) on the ACA's employer mandate rules
- [IRS Publication 969](#) ("Health Savings Accounts and Other Tax-favored Health Plans")
- [IRS Notice 2013-54](#) and [DOL Technical Release 2013-03](#) (guidance on integrated HRAs under the ACA)

Special Rules for Spouses

To help control costs, employers may encourage enrollment in a spouse's employer's health plan by:

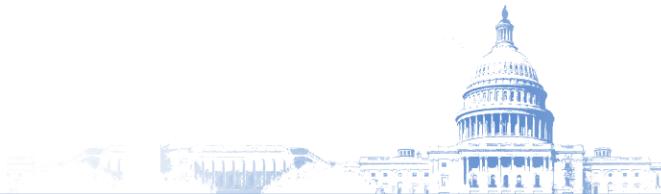
- Restricting spouses' eligibility;
- Requiring additional premiums for spousal coverage;
- Paying cash incentives to employees who opt out of their employer's coverage; and
- Reimbursing out-of-pocket expenses incurred under the spouse's health plan.

Key Compliance Issues

- Each type of special restriction or incentive for working spouses has its own set of compliance concerns.
- Any restriction or incentive should be applied uniformly to all plan participants, regardless of age, health status or other protected factor to help avoid discrimination concerns.

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Spousal Carve-outs and Surcharges

To help control costs, some employers have designed their plans to include spousal carve-outs or surcharges. These special rules encourage spouses to enroll in their employer-sponsored coverage when eligible. Typically, these restrictions do not apply to employees whose spouses are not employed (or whose spouses do not qualify for health coverage through their own employers). They can be particularly useful as cost-saving measures for health plans with generous coverage rules, employer contributions, or both.

How the Restrictions Work

A spousal carve-out removes or restricts eligibility for spouses, while a surcharge adds an extra cost to coverage. Carve-outs are typically viewed as a more aggressive cost-savings approach because they can eliminate eligibility altogether, while surcharges allow spouses to stay on the health plan for an extra cost. These special rules work as follows:

- A **spousal carve-out** can take a variety of forms. One type of spousal carve-out provides that working spouses with available health coverage through their own employers are ineligible for coverage through the employee. Another type of spousal carve-out requires working spouses to enroll in coverage offered by their employers to be eligible for coverage through the employee, allowing the employer's health plan to coordinate benefit payments with the spouse's health plan.
- A **spousal surcharge** is an additional premium or contribution that an employee must pay for spousal coverage if the spouse could enroll in coverage through their own employer but chooses not to.

Employers that implement a carve-out or surcharge may want to consider whether the restriction's applicability should depend on the cost or type of health coverage offered by the spouse's employer. For example, does the spouse's employer offer a comprehensive group health plan or just an individual coverage HRA, or ICHRA, and how much does the spouse's employer charge for coverage?

Also, any changes to spousal eligibility, such as a carve-out or surcharge, should be clearly described in plan-related documents that address eligibility, such as the Summary Plan Description (SPD), as well as open enrollment materials.

Potential Legal Issues

Federal law does not require employers to offer health coverage for spouses. The Affordable Care Act's (ACA) employer mandate rules require applicable large employers (ALEs) to provide health coverage to their full-time employees and dependent children or risk a penalty, but the coverage requirements do not apply to spouses. Thus, employers have a fair amount of flexibility under federal law regarding spousal eligibility. However, employers that want to restrict spousal eligibility (or implement a surcharge) should confirm this plan design is consistent with the terms of any underlying insurance policy or agreement. Also, state insurance laws include mandates for fully insured plans that may impact eligibility rules for spouses.

Additionally, to help avoid potential discrimination issues, spousal carve-outs and surcharges should be applied **uniformly to all plan participants**, regardless of age, health status or other protected factor. Although many states prohibit discrimination based on marital status, ERISA may preempt these laws to the extent they would apply to a private-sector employer's group health plan.

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Incentives to Waive Coverage

A less punitive cost-savings approach is to offer incentives to employees (and spouses) who opt out of the employer's health coverage and instead elect coverage through the spouse's employer. These incentives can be offered as taxable payments or, alternatively, an employer can adopt a spousal incentive HRA that reimburses cost-sharing amounts that are incurred under the spouse's employer's group health plan. As with traditional HRAs, the value of the HRA coverage is not taxable to covered employees, and any reimbursements that employees receive from the HRA for medical care are excludable from their income for tax purposes.

Taxable Opt-out Payments

Some employers offer their eligible employees a cash incentive to waive coverage under the employer's group health plan. These arrangements are often aimed at employees with working spouses eligible for health coverage through the spouse's employer. Most opt-out payments are significantly less than the amount the employer would otherwise spend if the employee enrolled in its health coverage. The payments are typically spread out over the plan year and are not paid in a lump sum, allowing the employer to reduce its risk of loss if an employee terminates employment.

While opt-out payments are generally permissible, there are various compliance issues that employers should consider before offering a cash incentive to waive coverage, including the following:

- **Tax issues**—As cash compensation, opt-out payments are **taxable to the employee**. While coverage under a group health plan is generally nontaxable, opt-out payments must be included in gross income on the employees' Form W-2 and are subject to federal income and employment tax withholding. Also, because opt-out payments give employees a choice between health coverage and taxable compensation, they must be offered through a Section 125 cafeteria plan.
- **ACA affordability**—To avoid penalties under the ACA, ALEs must offer affordable, minimum-value health coverage to full-time employees (and their dependent children). In general, the affordability of an employer's health coverage depends on whether the employee's required contribution for self-only coverage exceeds a certain percentage of the employee's household income. Depending on how the opt-out arrangement is structured, an ALE may be required to treat opt-out payments as **increasing an employee's contribution for health coverage** beyond the amount the employee would pay in premiums, making it more difficult for an ALE to satisfy the affordability standard.
- **Discrimination**—Opt-out payments should be **uniformly offered to all plan participants**, regardless of age, health status or other protected factor, to help avoid potential discrimination issues.
- **Overtime**—Opt-out incentives may impact the calculation of overtime payments under federal and state wage laws, depending on the facts of the specific opt-out incentive arrangement.

In addition, before offering a cash-out option for an insured plan, an employer should confirm that it does not violate minimum participation requirements or other insurance contract terms.

Spousal Incentive HRAs

A spousal incentive HRA works like a traditional HRA in many respects, but it is available only to employees who enroll in health coverage through a spouse's employer. By reimbursing employees on a tax-free basis for their eligible out-of-pocket

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expenses under a spouse's health plan, this type of HRA incentivizes employees to enroll in health coverage through their spouse's employer instead of their own employer.

Spousal incentive HRAs are subject to many legal requirements that apply to traditional HRAs, such as ERISA, COBRA and HIPAA. However, there are some compliance rules for spousal incentive HRAs that employers should be aware of when considering this type of plan design, including the following:

- **ACA integration**—Most HRAs must be integrated with other group health coverage to comply with the ACA's market reforms. One requirement for integration is that employees (and their spouses and dependent children) covered under the HRA must be enrolled in a group health plan that provides major medical coverage, regardless of whether their employer or another employer sponsors the plan. Thus, employees (and family members) covered by a spousal incentive HRA **must be covered by another employer-sponsored group health plan**. An employer may rely on an employee's reasonable representation of their coverage to satisfy this requirement.
- **HSA eligibility**—In general, individuals are ineligible for health savings account (HSA) contributions if they have health coverage that pays benefits before the annual minimum deductible for a high deductible health plan (HDHP) is met. Individuals whose medical expenses can be reimbursed by a spousal incentive HRA are not eligible for HSA contributions unless the HRA is designed to be compatible with HSA contributions. It does not matter whether an individual is covered by the HRA as an employee or as a spouse whose medical expenses can be reimbursed; both types of individuals are ineligible for HSA contributions. However, spousal incentive HRAs can be designed to be compatible with HSA contributions by including a post-deductible option for employees enrolled in a spouse's HDHP. Under this option, the HRA only reimburses cost-sharing expenses (e.g., copayments and coinsurance) that are incurred **after the minimum HDHP family deductible** has been reached for the year.
- **No premium reimbursement**—Spousal incentive HRAs generally cannot reimburse the spouse's premiums for coverage under their employer-sponsored health plan. In most cases, a spouse will pay their premiums for health coverage on a pre-tax basis through a Section 125 cafeteria plan. Federal tax law prohibits an HRA from reimbursing premiums for coverage paid on a pre-tax basis.
- **ACA reporting**—The ACA requires certain employers to report information to the IRS each year about the health plan coverage they offer (or do not offer) to their employees. In general, HRAs are considered self-funded health plans subject to ACA reporting. An exception allows employers to avoid the coverage-reporting requirements for an HRA where the employee is enrolled in other major medical coverage through that employer. This exception does not apply to spousal incentive HRAs because employees waive health coverage through their employer to access the HRA's benefits. Thus, sponsoring a spousal incentive HRA adds to the existing reporting obligation for ALEs and non-ALEs with self-funded health plans. Moreover, sponsoring a spousal incentive HRA will trigger ACA reporting requirements for non-ALEs with fully insured health plans that otherwise would not be subject to ACA reporting.