California Public Employees' Retirement System
P.O. Box 942715
Sacramento, CA 94229-2715
(888) CalPERS (or **888**-225-7377)
TTY: (877) 249-7442
www.calpers.ca.gov

Circular Letter No.: 600-038-16
Distribution: VI, X, XII, XVI, Special

Circular Letter

July 7, 2016

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

SUBJECT: **NEW AFFORDABLE CARE ACT RULES AND NOTICE IMPORTANT FOR CALPERS EMPLOYERS**

The purpose of this Circular Letter is to provide information to Health Benefit Officers and other personnel staff regarding the concurrent release, in December 2015, of a final rule and notice issued by the Treasury Department and Internal Revenue Service (IRS), and other implementing departments, related to the Affordable Care Act (ACA). The final rule is titled "Minimum Value of Eligible Employer-Sponsored Plans and Other Rules Regarding the Health Insurance Premium Tax Credit." IRS Notice 2015-87 is titled "Further Guidance on the Application of the Group Health Plan Market Reform Provisions of the Affordable Care Act to Employer-Provided Health Coverage and on Certain Other Affordable Care Act Provisions." CalPERS contracting public agencies and schools (CalPERS Employers) should carefully review the rule and notice to determine how they may be impacted. [1]

This Circular Letter does not discuss every impact the rule and notice may have upon CalPERS Employer practices; rather, this Circular Letter merely highlights a few potential common practices which may be affected.

One such practice is the offering of a § 125 cafeteria plan to employees,[2] which many CalPERS Employers have established over the years as a response to mandatory requirements for participating in CalPERS.[3] Under the ACA, the affordability of an employer's offer of health coverage to its full-time employees and any corresponding tax consequences depends upon whether the employee's required contribution exceeds a certain percentage of household

---

[1] CalPERS staff continue to assess laws and regulations related to the ACA, which may affect contracting agencies and other employers. While we make every effort to assist 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 contracting 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.

[2] A cafeteria plan is a plan maintained by an employer for employees that meets certain Internal Revenue Code requirements and provides participants an opportunity to receive certain benefits on a pretax basis. See https://www.irs.gov/government-entities/federal-state-local-governments/faqs-for-government-entities-regarding-cafeteria-plans for general information about cafeteria plans.

[3] See Government Code § 22892. This section requires that employers provide equitable contribution amounts to employers and annuitants.

income.[4] The final rule provides the circumstances under which amounts made available through a § 125 cafeteria plan reduce an employee's required contribution for health benefits for purposes of determining whether an applicable large employer has made an offer of affordable minimum value coverage and whether that employer may be subject to an assessable payment for failure to offer affordable coverage.[5]

Section 26 CFR 1.36B-2(c)(3)(v)(A)(6) of the final rule states the following:

> Employer contributions to cafeteria plans.
> Amounts made available for the current plan year under a cafeteria plan, within the meaning of section 125, reduce an employee's or a related individual's required contribution if—
>
> (i) The employee may not opt to receive the amount as a taxable benefit;
>
> (ii) The employee may use the amount to pay for minimum essential coverage; and
>
> (iii) The employee may use the amount exclusively to pay for medical care, within the meaning of section 213.

Notice 2015-87, Question and Answer (Q&A) #8, further clarifies that employer flex contributions to a cafeteria plan will reduce an employee's required annual premium contribution for self-only coverage, for purposes of determining affordability, if the contribution is considered a "health flex contribution" under § 26 CFR 1.36B-2(c)(3)(v)(A)(6) above.[6] Employer flex contributions that are available to pay for health care but that may also be used for non-health care benefits under a § 125 cafeteria plan, or could be received as cash, are not health flex contributions and, therefore, do not reduce the required employee contribution. The notice provides examples of when an employer's flex contribution will or will not reduce an employee's required contribution.

Under certain circumstances, there may be transitional relief for some CalPERS Employers. For coverage in plan years beginning before January 1, 2017, employer flex contributions that are not health flex contributions generally will be treated as reducing the amount of an employee's required contribution for purposes of applicable large employer information reporting under § 6056 (line 15 of Form 1095-C). For plan years beginning on or after 2017, however, employer flex contributions that do not comply with the health flex contribution requirements set forth in the rule and notice do not offset an employee's contribution for health coverage when determining whether an employer's coverage is affordable, and thus could increase a large employer's chances of assessable payments under § 4890H(b).

Another common practice in which some CalPERS Employers may participate is offering payments conditioned solely on an employee declining employer-sponsored health coverage.

---

[4] See §§ 36B and 5000A regarding affordability and employee contributions; also see § 4980H(b), including under the § 54.4980H–5(e)(2) affordability safe harbors, regarding penalty assessment.
[5] See § 54.4980H-5 for information regarding assessable payments and affordability. https://www.gpo.gov/fdsys/pkg/FR-2014-02-12/pdf/2014-03082.pdf
[6] Section 1.36B-2(c)(3)(v)(A)(6) adopts the "health flex contribution" rule under § 1.5000A-3(e)(3)(ii)(E) for purposes of determining affordability under § 36B.

These employers should review Q&A #9 which provides that employer payments made available only to an employee if he or she declines or opts-out of employer-sponsored health coverage are generally added to the employee's lowest cost plan option for purposes of affordability. The Treasury and IRS have determined it is generally appropriate to treat an "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 employer's health plan will be added to the employee's required contribution for purposes of applicable large employer information reporting under § 6056 (line 15 of Form 1095-C). The notice provides the rationale for this determination.

According to the notice, the Treasury and IRS intend to issue regulations regarding the treatment of opt-out payments and anticipate that the payment will be included in the employee's required contribution, for purposes of determining affordability, under an unconditional opt-out arrangement. Prior to the applicability date set forth in future regulations, however, employers are generally not required to increase the amount of an employee's required contribution by the amount of the opt-out payment when reporting under § 6056 and will not be treated as increasing an employee's required contribution for purposes of potential penalty assessment under § 4890H(b).

There are other sections of the notice that may be of importance to CalPERS Employers. For example, Q&A #14 and #15, respectively, address how to account for periods in which an employee is receiving short- or long-term disability payments, and how to apply the special rehire rule for employees who primarily perform services for educational institutions. The notice also provides guidance regarding calculating hours of service to determine whether an individual is a full-time employee under § 4890H, includes new guidance regarding health reimbursement accounts and health savings accounts, and clarifies the application of the 9.5 percent affordability threshold adjustment and the 2015 and 2016 penalty assessment adjustment, as well as other information.

In sum, CalPERS Employers should carefully review their benefit structure (e.g., whether they, like many CalPERS Employers, offer § 125 cafeteria plans or opt-out payments to employees who forego enrollment in their employer-sponsored health coverage) in light of this new guidance so as not to risk future federal penalties for failure to offer affordable health coverage or run afoul of other guidance described in the notice.

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

Shari Little, Chief
Health Policy Research Division