

October 1, 2024

Employee Benefits Compliance

Limiting Spousal Participation: A Closer Look at Spousal Carve-Outs, Surcharges, and HRAs

Overview

As employers look for new ways to limit medical plan costs, restrictions on spousal medical plan participation are increasingly popular. Spousal participation restrictions often interest employers that sponsor generous coverage either by plan design, employer contribution, or both. This Insight addresses the compliance issues with various approaches to limiting spousal participation, including certain designs managed by third-party vendors.

Plan Eligibility and Cost-Related Approaches to Limiting Spousal Enrollment

Historically, the two most common methods to limit spousal participation are spousal exclusions, where spouses are generally not eligible to participate under the terms of the plan (often referred to as "carve-outs") and spousal surcharges where the employee must pay an increased premium for the spouse to enroll in the plan.

Plans sponsors can design spousal exclusions in a way that excludes them outright so that they are never eligible to participate. This approach is not common, likely in part because coverage that does not extend to an employee's spouse can impact employee attraction and retention. The more common approach is a conditional exclusion where spouses are only eligible if they do not have access to other employer-sponsored coverage. In some cases, even coverage available under a "skinny" or "MEC-only" plan (e.g., a plan providing only preventive care) or excepted benefits coverage (such as dental or vision) offered by a spouse's employer is used as a basis to exclude the spouse. For more information on MEC-only plans, see our [Alliant Insight: Minimum Essential Coverage](#).

By contrast, spousal surcharges do not limit or condition the spouse's eligibility but simply impose a higher premium for spousal coverage, which deters participation by spouses who have access to other coverage.

Another less targeted approach to incentivize participation in a spouse's plan is a cash-in-lieu design, where an employee who waives medical coverage receives a certain amount of cash from the employer. This cash is taxable income to the employee. For additional information on cash-in-lieu designs, see our [Alliant Insight: Rethinking Flex Credit and Opt-Out Credit Designs](#).

Compliance Considerations for Plan Eligibility and Cost-Related Approaches

ERISA and the ACA

The Employee Retirement Income Security Act (ERISA) does not require a health and welfare plan to offer coverage to spouses and children. While the ACA Pay or Play mandate requires large employers (generally those with 50 or more employees) to offer sufficient coverage to full-time employees and their dependents, or potentially face penalties, the term dependents in this context means dependent children up to age 26, and does not include spouses. Given these rules, employers have a fair amount of flexibility in designing spousal eligibility provisions from a compliance perspective.

Despite this flexibility, plans with spousal exclusions or surcharges should clearly define those eligibility provisions in plan-related documents, including any summary plan description (SPD) that addresses eligibility, as well as in all open enrollment materials. Plan sponsors should review documents prepared by third party service providers to ensure they do not inadvertently refer to spousal coverage (e.g., HIPAA special enrollment rights for spouses).

Tax and Reporting Implications

For plans that offer a cash-in-lieu, that amount must generally be included in compensation for calculating the overtime rate of pay. (For a full discussion of this issue, see our [Alliant Insight: Rethinking Flex Credit and Opt-Out Credit Designs](#).) Cash-in-lieu designs also implicate certain reporting for large employers under the ACA. Specifically, the ACA requires that large employers, report on the offers of coverage made to full-time employees and their dependents, including the cost of the coverage, on Form 1095-C. (For additional information, see our [ACA Reporting Guide](#).) Regulatory guidance requires cash-in-lieu payments to be included as part of the cost of coverage for affordability purposes under Pay or Play, unless the cash-in-lieu is designed as a "conditional" opt out. That means the employee, before taking the cash payment, must verify that he/she and all members of their tax family (including spouses) already have minimum essential coverage that is not individual market coverage (e.g., coverage through another employer, Medicare, Medicaid, Tricare, etc.).

To address spousal exclusions, the IRS instructions for Form 1095-C include two codes that should be used to describe conditional offers of coverage to a full-time employee's spouse (e.g., offers that are made only if the spouse is not eligible under his or her own employer plan). These codes apply to spousal *exclusions* and are not relevant for spousal surcharges because the cost of coverage reporting on Form 1095 is the employee-only cost.

Vendor-Offered Spousal Health Reimbursement Arrangements

In addition to the more traditional approaches set forth above, in recent years we have seen the emergence of a vendor-designed health reimbursement arrangement (HRA) that limits spousal participation. By way of quick background, an HRA is a self-funded medical reimbursement plan subject to various legal requirements including ERISA, COBRA, HIPAA and the ACA. Under a long-standing ACA rule prohibiting lifetime and annual limits on essential health benefits, employers generally cannot offer an HRA on a stand-alone basis. Instead, an HRA generally must be integrated with a major medical plan, and those rules do allow an HRA offered by one employer to integrate with another employer's plan. (For additional information on HRAs, see our [Compliance Insight: HRAs Rules and Issues](#).) This ability to integrate HRAs with another employer's plan (e.g., through the spouse's employer or an employee's second job) is the foundation for this particular design, referred to in the market as a spousal incentive health reimbursement arrangement (SIHRA).

There are numerous approaches employers can adopt when implementing a SIHRA. One option requires that the employee's spouse enroll in their employer's group health plan and the SIHRA will reimburse any cost-sharing the employee incurs on behalf of their spouse under the spouse's plan, such as deductible, copayments, and coinsurance. Another option is for the employer to make the SIHRA available only to employees who waive enrollment in the employer-sponsored group medical plan for both themselves and their spouse, in which case the SIHRA will reimburse the cost-sharing required under the spouse's plan. In both situations the SIHRA integrates with the spouse's employer's group medical plan.

Compliance Considerations with SIHRAs

Regardless of the design used to integrate the HRA with another employer's group medical plan, these arrangements present a number of compliance challenges for employer plan sponsors to consider before adopting a SIHRA.

ACA Compliance Issues

Integration. As outlined above, the ACA requires most HRAs to be integrated with employer sponsored major medical coverage. To comply with that rule, employer plan sponsors offering a SIHRA must satisfy the following requirements:

- The employer must offer a group health plan that does not consist solely of excepted benefits to the employees being offered the HRA, even if the employees must waive this coverage to participate in the HRA.
- Employees (and their spouses and dependents) receiving the SIHRA must actually be enrolled in an employer-sponsored group health plan that does not consist solely of excepted benefits, not coverage through the individual market, the Exchange, Medicare, or Medicaid.
- The SIHRA must be available only to employees (and their spouses and dependents) who are actually enrolled in an employer-sponsored group health plan.
- The employer must offer the employee the ability to opt-out of the SIHRA at least annually.

Notably, when a SIHRA is integrated with the spouse's employer's group medical plan and the spouse's plan does not provide minimum value, the only expenses that can be reimbursed from the SIHRA are deductible, copayments, and premiums under the spouse's employer's group medical plan, plus medical care expenses that are not essential health benefits (EHBs). Practically this limitation should not present an issue because SIHRAs are typically limited to only cost-sharing amounts under the spouse's employer's group medical plan.

Even though the ACA permits HRA integration with another employer's major medical plan, from a practical perspective this arrangement can present significant administrative challenges. Specifically, it requires real-time claims substantiation because the plan must confirm that the other employer coverage was in force at the time the expense was incurred.

In addition to the integration issues, the following ACA related rules impact these designs:

Affordability and Actuarial Value. When a SIHRA is only available to employees who waive coverage under the employer's group medical plan in favor of coverage under a spouse's employer's plan, the SIHRA contributions cannot be counted in determining either affordability or minimum value of the employer's group medical plan for ACA pay or play purposes.

PCORI Fees. Employer plan sponsors are required to pay PCORI fees for any HRA they sponsor. The fee is generally calculated based on the average number of covered lives under the plan, but HRAs are to count only employee lives, not participants. SIHRAs cannot, however, take advantage of another special rule here which provides that if an employer offers two or more self-funded plans and both plans have the same plan year, an employer may treat them as a single health plan when calculating the PCORI fee. This exception is not available for SIHRAs because the HRA is integrated with another employer's plan, and as a result the employer plan sponsor may have additional PCORI fee liability with this design. For additional details on the PCORI fee, see our [Compliance Insight: PCORI Fees](#).

Minimum Essential Coverage (MEC) Reporting. The ACA requires every provider of minimum essential coverage (MEC) to report that coverage information to the Internal Revenue Service (IRS) and to covered individuals on Form 1095-C or Form 1095-B, as applicable. There is a special rule that allows employers to avoid this reporting for an HRA, but this exception is only applicable when the employee is enrolled in other major medical coverage through that same employer. Where a SIHRA is available only to employees who waive coverage under the employer's group medical plan, the employer plan sponsor will be required to report coverage under the SIHRA on Form 1095-C or Form 1095-B, as applicable. This requires listing each employee and family member whose healthcare expenses can be reimbursed from the SIHRA. While this reporting obligation likely won't be overly burdensome for ALEs already required to prepare Forms 1095-C, this will be an additional obligation for employers that sponsor only fully insured medical plans.

COBRA

HRAs, including SIHRAs, are employer-sponsored group health plans subject to COBRA. This means that when qualified beneficiaries lose their SIHRA coverage due to a COBRA qualifying event (e.g., termination of employment, divorce, etc.), they must receive a COBRA election notice that includes the option to continue coverage under the SIHRA. Employers subject to COBRA should engage their COBRA administrator to ensure SIHRA participants are provided the opportunity to continue their SIHRA coverage for up to the maximum COBRA coverage period. The COBRA challenges associated with HRAs, including development of a COBRA premium, also exist for SIHRAs, and the SIHRA vendor should provide support for this requirement. For more details regarding these COBRA challenges, see our [Compliance Insight: HRA Rules and Issues](#).

SIHRA and HSA Interaction

To be eligible to contribute to an HSA, an individual must have coverage under a qualified High Deductible Health Plan (QHDHP) and generally must not have any non-HDHP coverage. A general purpose HRA that pays or reimburses qualified medical expenses without application of a deductible is impermissible non-HDHP coverage and prevents HSA eligibility. This rule applies even where an individual's qualified medical expenses can be paid or reimbursed under a spouse's employer sponsored HRA. Therefore, if a SIHRA is integrated with another employer's QHDHP, participants should understand that enrolling in the SIHRA will disqualify the individuals whose expenses can be reimbursed by the SIHRA from HSA eligibility. This may require the spouse to notify their employer not to make employer provided HSA contributions on behalf of the spouse, or potentially face adverse tax implications.

Section 105(h) Nondiscrimination

SIHRAs are also subject to the §105(h) non-discrimination rules designed to prevent discrimination in favor of highly compensated individuals ("HCIs"). There are two non-discrimination tests that apply to self-funded health plans under §105(h): an Eligibility test and a Benefits test. If a self-funded health plan fails to pass either test, some or all of the favorable tax treatment of reimbursements to HCIs is lost. While employers sponsoring a SIHRA should be aware of these rules, it's worth noting that these non-discrimination rules have applied to self-funded group health plans for years with no active enforcement. For additional information on this topic, see our [Compliance Insight: §105\(h\) Non-Discrimination Rules](#).

No Reimbursement of Pre-Tax Premiums and Medicare

An HRA cannot reimburse premiums that have already been paid for on a pre-tax basis. Given that premiums under the spouse's plan will almost always be paid on a pre-tax basis through a Section 125 cafeteria plan, a SIHRA will generally be prohibited from reimbursing medical plan premiums for the spouse's plan. SIHRAs that allow such reimbursements could lose their qualified status, resulting in all HRA reimbursements to be taxable income for all participants.

The Medicare Secondary Payer (MSP) rules also prohibit employer-sponsored group health plans from "taking into account" the Medicare entitlement of a current employee or a current employee's spouse or family members. This includes providing financial or other incentives to waive the employer's group health plan in favor of Medicare enrollment. Therefore, the MSP rules prohibit SIHRAs from reimbursing Medicare premiums or Medicare supplement premiums. For additional details on the MSP rules, see our [Compliance Insight: Medicare and Group Health Plans](#).

Other Group Health Plan Requirements

ERISA. SIHRAs are generally subject to ERISA when sponsored by an employer that is subject to ERISA. Accordingly, SIHRAs require a plan document and SPD, or inclusion in a wrap SPD, and are subject to the Form 5500 requirement. SIHRAs must also comply with ERISA's claims and appeals procedures and ERISA's

standard fiduciary duties are also applicable. For additional details, see our [Compliance Insight: ERISA Plan Documents and 5500 Filings](#).

HIPAA Privacy and Security Rules. As a self-funded group health plan, SIHRAs are also subject to HIPAA's privacy and security rules. Employers sponsoring SIHRAs must put into place any policies and procedures, safeguards, contracts, and other mechanism required for compliance with HIPAA's privacy and security rules. For additional details, see our [Compliance Insight: HIPAA Foundation for Employer Plan Sponsors](#).

Domestic Partner Health Plans. Like integration with a spouse's employer's plan, SIHRAs may be integrated with a domestic partner's employer's group health plan. However, HRAs cannot reimburse a non-tax dependent domestic partner's health care expenses because it does not qualify as an eligible §213(d) medical expense. This won't be an issue for SIHRAs limited to reimbursing the employee's health expenses through a spouse's or domestic partner's employer's plan, but if the SIHRA is designed to reimburse the spouse's cost-sharing expenses this approach cannot extend to any non-tax dependent domestic partners. Instead, the employer can only reimburse a non-tax dependent domestic partner's health care expenses on a taxable basis.

Employer Takeaways

Spousal exclusions or surcharges, and the fairly recent SIHRA approach, can be attractive ways for an employer plan sponsor to manage costs. A plan considering such an approach should review their demographics and, if possible, their claims data to determine whether the proposed approach would truly have the intended impact. Not all plans would see significant cost savings with these eligibility restrictions or incentives. Moreover, an employer should also consider the impact such a decision would have on the ability of the organization to retain and attract talent. Particularly with respect to spousal exclusions or surcharges, the wisdom and efficacy of such an approach will be largely dependent on whether such plan designs are common in their industry.

Contact your Alliant representative if you have additional questions about this issue.

Disclaimer: This material is provided for informational purposes only based on our understanding of applicable guidance in effect at the time and without any express or implied warranty as to its accuracy or any responsibility to provide updates based on subsequent developments. This material should not be construed as legal or tax advice or as establishing a privileged attorney-client relationship. Clients should consult with and rely on their own independent legal, tax, and other advisors regarding their particular situations before taking action. These materials and related content are also proprietary and cannot be further used, disclosed or disseminated without express permission.