

Spousal and Dependent Carve-Outs and Surcharges

Issue Date: February 2018

Background

As healthcare costs continue to rise, more and more employers are considering implementing eligibility carve-outs and premium surcharges as a strategy to reduce costs. Some employers may choose to completely exclude spouses or dependents from being eligible for coverage, but others take a less aggressive approach, excluding only certain spouses or dependents (e.g. those who are eligible for or enrolled in other group health coverage). Another option, rather than excluding such individuals from being eligible for benefits, is to impose a surcharge for those who choose to enroll. Although spousal carve-outs and surcharges are generally allowed, carve-outs and surcharges for dependent coverage will often violate requirements under the Affordable Care Act (ACA). For those considering making changes to spousal and/or dependent coverage, the design and administration of those changes should be considered carefully.

Federal Compliance Considerations

Spouses

Employers are not required to offer coverage to spouses. Employers choosing to offer coverage to spouses have the flexibility to impose a surcharge for those spouses who enroll, or to completely carve-out spousal eligibility, without violating benefit compliance rules.

Dependent Children

Imposing a dependent carve-out or surcharge is more challenging, and in many cases it may not be possible because of two separate requirements under the ACA, as explained below.

- *§4980H – Employer Mandate*

Although a small employer (less than 50 FTEs) can choose not to offer coverage to dependent children, applicable large employers (50 or more FTEs) must offer coverage to full-time employees and their dependent children to avoid §4980H penalties.

- *Coverage to Dependents Until Age 26*

In addition to what is required under §4980H, the ACA requires employers of any size who choose to offer coverage to dependent children to offer such coverage until age 26. The requirement is that coverage must be offered to dependents as defined under Code §152(f)(1) until age 26 without regard to tax dependency, residency, marital status, employment status, eligibility for other coverage, and/or student status (*Treas. Reg. § 54.9815-2714(b)(1)*). Therefore, it would violate this rule to make coverage for a dependent child conditional upon things such as marital status or enrollment in other coverage.

***Code §152(f)(1) defines “child” as “a son, daughter, stepson, or stepdaughter of the taxpayer, or...an eligible foster child of the taxpayer.” The plan is not required to include in the definition of a dependent those who fall outside the Code §152(f)(1) definition of “child,” such as the niece/nephew or grandchild of a legal guardian; and if the plan does choose to include those individuals in the definition, it may impose additional restrictions. See FAQ at <https://www.dol.gov/sites/default/files/ebsa/about-ebsa/our-activities/resource-center/faqs/aca-part-i.pdf> (Q/A #14).

Imposing a surcharge could also be an issue depending upon how the surcharge is structured. Imposing a surcharge only for certain dependent children (e.g. those who are married, those who have coverage through their own employment, or those who have coverage available through another parent) could be an issue under the ACA if the surcharge is tied in any way, even tangentially, to the age of the dependent. If the employer continues to make coverage available to dependent children and doesn't restrict any of the benefits, it may be possible to impose a surcharge so long as it is not based on age. However, if the surcharge applies only for those who have other job-based coverage or who are married, that is likely to be an issue since it would apply only to adult children.

Design and Administrative Considerations

Because carve-outs for dependent children are generally available only to small employers, and coverage surcharges for dependent children will typically pose an issue under ACA requirements for employers of all sizes, the design and administrative considerations outlined below focus on spousal carve-outs and surcharges. In the context of a fully insured plan, although surcharges are generally not an issue, keep in mind that some carriers do not allow carve-outs.

Eligibility

An employer should first consider what form of eligibility rules the employer wishes to implement. There are three basic approaches beyond excluding all spouses, outlined below.

1. Spousal Carve-Out

With this approach, the employer defines plan eligibility so that spouses are ineligible to participate if they are eligible for other employer-sponsored coverage. The employer should decide whether eligibility will be affected by the type or cost of other coverage available. For example, will the spouse still be ineligible if their employer offers only a limited-medical (mini-med) plan, or if the other plan is significantly more expensive?

2. Spousal Surcharge

Imposing a surcharge (i.e. a larger employee contribution) for spouses who are eligible for other employer sponsored coverage provides an incentive for spouses to choose to enroll in the other coverage while still allowing eligibility in the employer's plan for those who need it. However, this approach may create an extra level of complexity in the communication and administration of benefits and payroll.

3. Eligibility Restricted to When Other Coverage Is Also Elected

Some employers define eligibility in such a way that if a spouse has other coverage available, the spouse must enroll in that coverage to be eligible for the plan. Allowing spouses to enroll in the plan only if they also enroll in other available coverage makes the employer plan the secondary payer for claims purposes. This strategy can reduce plan costs while still allowing spouses to enroll in the employer's plan when necessary. Spouses are also less likely to enroll in the employer's plan if they already have other coverage.

NOTE: The above approaches assume that if all spouses are not being completely excluded from coverage eligibility, that the carve-out or surcharge considers only coverage under another group health plan (e.g. through the spouse's employer). Tying the carve-out or surcharge to non-group coverage such as Medicare would likely violate Medicare Secondary Payer (MSP) rules. See more detail below.

Verification

When an employer decides to impose a spousal surcharge or to carve-out coverage eligibility for those spouses who are eligible for group health coverage elsewhere, the employer must decide exactly how such coverage will be verified and must follow the process on a uniform basis for all employees with spouses who may be eligible for the plan. This is generally accomplished through use of an employee affidavit, by performing periodic eligibility audits, by requesting actual certification from the spouse's employer, or by some combination of these approaches. When making this decision, the employer must weigh time and cost considerations against the potential for plan savings. Also, if this involves a fully insured plan, the insurance carrier may have some requirements of its own. Each option is outlined in greater detail below.

- *Employee Affidavits*

The simplest, and perhaps most common, approach is to require a signed affidavit from the employee that certifies that the spouse is not eligible for other employer sponsored coverage. The success of this approach depends on the employee's providing accurate information. Compliance can be increased by making it clear that significant consequences (e.g. loss of coverage and/or premium repayment) will result if accurate information is not provided. An employer using this approach must consider and communicate whether certification upon enrollment will suffice for the plan year or whether the employee is expected to update the employer of any changes mid-plan year.

- *Eligibility Audits*

Some employers perform periodic eligibility audits to ensure that only eligible individuals are enrolled in the plan coverage. In addition to reviewing spousal eligibility, these audits often review other issues, such as dependent eligibility.

- *Certification from Spouse's Employer*

A few employers require the spouse to obtain from their employer a signed form or certification that provides the information necessary to make an eligibility determination. Although this approach ensures that the employee and/or spouse is providing accurate information, it also increases the administrative burden on the employer and on employees. The spouse's employer is under no legal requirement to provide the information. If the spouse's employer refuses, the employee and spouse are put in a difficult position. In addition, the spouse's employer may be prohibited from providing plan enrollment information directly to another employer because of HIPAA privacy rules. To avoid this problem, the certification process should require that the spouse obtain the certification from their employer and then provide it to the plan.

Other Compliance and Employee Relations Issues

Medicare Secondary Payer (MSP) Rules

MSP rules, which apply to employers with 20 or more employees, require that employees (and their spouses) age 65 and older be offered the same benefits and not be incentivized not to take the employer's group health plan. In addition, similar rules apply to employers with 100 or more employees for disability-based Medicare. Making spouses ineligible, or imposing a surcharge, if the spouse is eligible or enrolled in Medicare would violate these rules.

Grandfathered Plan Status

A spousal surcharge could affect a plan's grandfathered status under the Patient Protection and Affordable Care Act (the ACA). To retain grandfathered status, an employer must refrain from reducing the percentage of premium paid by the employer by more than 5% for any tier of coverage, as compared to what the employer contributed on March 23, 2010. If the imposition of a spousal surcharge reduces the employer contribution below that level, the plan would lose grandfathered status even if it affects only a small number of employees.

HIPAA Special Enrollment Rules

Employers should consider how their rules will affect the spouse's ability to enroll in the spouse's employer-sponsored plan, especially if the plans have different plan years. Loss of coverage triggers a HIPAA special enrollment, so in the case of loss of eligibility due to a spousal carve-out, HIPAA would require the spouse's employer sponsored plan to allow the spouse to enroll in that plan mid-year. However, implementation of a surcharge is not a HIPAA special enrollment and would not require the spouse's employer to allow a mid-year enrollment, unless the employer eliminates any employer contribution for spousal coverage (i.e. the employee pays 100%). The spouse's plan may allow it based on its own eligibility rules, but would not be required to. In this case, the employee may be forced to pay the higher spouse surcharge amount until the spouse has an opportunity to enroll in their own plan.

COBRA

A spousal carve-out will not trigger COBRA continuation rights for spouses currently covered by the employer's plan. Loss of eligibility that arises because of a plan change is not a COBRA qualifying event for the spouse. Although some employers may be tempted to offer COBRA in this situation, an insurance carrier or stop-loss provider might not provide coverage since it is not an actual COBRA event.

Section 125 Cafeteria Plan Issues

Employers should also be aware that the spouse's ability to make election changes in their employer-sponsored plan will depend on that plan's definition of allowable status-change events. As described above, health plans are required to allow mid-year election changes in the case of HIPAA special enrollment events; however, other Section 125 status changes are optional and can vary from plan to plan.

Interaction with State Laws

States may have conflicting laws that also must be considered. For example, a state's insurance law may define certain spousal or dependent coverage. In addition, some jurisdictions may have marital discrimination laws that could be interpreted to prohibit a spousal carve-out or surcharge. Although ERISA preemption may provide protection from such requirements for certain plans (e.g. self-funded plans subject to ERISA), employers should consult with legal counsel to make sure their strategy does not violate any state or local laws.

Plan Documentation

Employers that implement a spousal carve-out or surcharge must update plan document(s) and summary plan description(s) so that they reflect the new enrollment rules. Employers should also carefully and clearly describe the eligibility requirements, along with any verification procedures and potential consequences; they should also make sure to communicate these things to employees, generally as part of the enrollment process.

Summary

The cost benefits of imposing a carve-out or surcharge will vary from employer to employer and might have a larger impact on self-funded plans. Using spousal carve-out or surcharge strategies can be an effective way to reduce plan costs, but employers should first carefully consider the different approaches and make sure compliance-related issues are properly addressed. Carve-out provisions or coverage surcharges for dependent children, on the other hand, will generally violate ACA requirements.

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