

# Benefits BRIEF



## Spousal Carve-Outs & Surcharges

• March 2023 •

Employers looking to lower their health plan costs have considered some strategies to reduce the number of participants. Among these strategies are spousal surcharges and carve-outs, which either impose an additional or increased employee contribution or restrict eligibility for spouses with access to a health plan through their employer. A more aggressive approach excludes spouses from enrolling in the plan altogether. These designs are also known as “working spouse provisions.” When one of these strategies is implemented, employers ultimately pay less in premiums (or claims for self-funded plans) than they would have if the spouses were enrolled. Employers considering one of these strategies must first consider the specific eligibility strategy they want to implement and the various federal and state law implications.

### Spousal Eligibility Restrictions

Employers that don’t want to exclude spouses from their plan completely may choose to restrict their eligibility by imposing different strategies. One such strategy is a spousal carve-out. A **spousal carve-out** is a plan provision that **excludes or restricts** spouses from being eligible for the employer’s group health plan when they are eligible or enrolled in their own employer’s health plan.

Another approach to limit spousal eligibility in the plan is a spousal surcharge. A **spousal surcharge** is an **additional or increased employee contribution** amount when an employee enrolls a spouse that is eligible for coverage through their employer’s health plan.

A third, less aggressive approach employers may implement is allowing the spouse to enroll in the employee’s plan if they are also enrolled in their own employer plan (if applicable). In effect, the employer’s plan becomes a secondary payer to the spouse’s plan, potentially lowering costs for the employer.

### Compliance Considerations

Whether an employer chooses the spousal surcharge or carve-out strategy, they must review the legal compliance considerations on their plans and prepare for any potential risks.

- **ACA Pay or Play Rules.** The ACA's employer mandate does not require employers to offer coverage to spouses, so a spousal carve-out or surcharge is permitted. In some cases, these provisions can be beneficial for spouses. When spouses are ineligible, or the cost of the plan is too expensive, they could be eligible for a subsidy through the Exchange.
- **ACA Reporting.** When the employer completes Form 1095-C, they must use either Code 1J (for plans that do not offer coverage to non-spouse dependents) or Code 1K (for plans that do offer coverage to non-spouse dependents) in Line 14 of the Form 1095-C to indicate that the employee's spouse received a conditional offer of coverage.
- **ACA Grandfathered Plans.** A spousal surcharge may cause a health plan to lose its grandfathered plan status.
- **State Laws.** Many states have laws that prohibit discrimination based on marital status or sex. In addition, some states require specific spousal coverage. For self-insured plans subject to ERISA, such state laws will generally be preempted by ERISA, meaning that the state law will not prevent an ERISA plan from excluding spouses or imposing a surcharge. However, this won't be the case for fully insured plans. If a plan is not subject to ERISA (such as church or government employers) or is fully insured, then ERISA will not offer any protection from applying state or local jurisdiction laws (e.g., statutes, regulations, and case law).
- **Medicare Secondary Payer (MSP) Rules.** Employers should ensure that their plan's eligibility restrictions apply uniformly to all participants. An employer who excludes Medicare-eligible spouses from the plan may violate the MSP rules, which prevents employers with 20 or more employees (including private and public sector employers and nonprofit organizations) from offering Medicare-eligible employees the same benefits as individuals under age 65.
- **HIPAA Special Enrollment.** If an employer implements a new spousal carve-out rule and an employee's spouse becomes ineligible for the employer's coverage, the loss of coverage for the spouse will trigger a HIPAA special enrollment and require the spouse's employer to allow a special mid-year enrollment. However, the HIPAA special enrollment rules do not apply to a new spousal surcharge.
- **Section 125 Rules.** Employers offering Section 125 Cafeteria Plans that offer pre-tax contributions for employees allow for midyear election changes for qualifying events in addition to HIPAA's special enrollment periods. Since these events can vary from plan to plan, it could be difficult for a spouse to change their election with their employer's plan. Also, employers should be cautious that their plan doesn't run afoul

of the Section 125 non-discrimination rules, which prevents employers from favoring highly compensated employees.

- **COBRA.** Though the loss of coverage is a qualifying event under HIPAA special enrollment rules, the loss of eligibility due to a plan change (like a spousal carve-out) 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.
- **Plan Documents & Summary Plan Descriptions (SPDs).** Employers implementing a spousal carve-out or surcharge must update their plan documents and SPDs to reflect the new rules clearly. Employers should also include any verification procedures and potential consequences. This information should also be included in all of their enrollment materials.

## Other Considerations

In addition to the compliance considerations, employers should evaluate other potential issues and prepare proactively for them.

- **Employee Perception.** Employers should be cautious of employee perception. In addition to being perceived as a benefit being taken away from them, adding a surcharge raises fairness issues for affected employees and could impact their “family-friendly” culture.
- **Eligibility Verification.** How will employers verify eligibility status or when to include a surcharge? Will they use an attestation form or require documentation through the spouse’s employer? If an attestation form is used, they must decide if there will be any consequences to employees that do not answer truthfully or if the form is not received timely. Will it be required every year or only when the spouse’s circumstances change?
- **Exceptions.** When designing the plan for a spousal carve-out or surcharge, employers should consider if they will allow any exceptions to the new rules (e.g., if a spouse works part-time, their employer’s plan is unaffordable, or when the plan offers less coverage).
- **Definition of Spouse.** Employers must decide if the new rules will apply to domestic partners, civil union partners, common-law partners, surviving spouses, etc. Also, what is the impact (if any) on married employees working for the same employer?
- **Collective bargaining agreements (or other contractual obligations).** Employers should review any collective bargaining agreements or other contractual obligations for potential conflicts if they decide to impose a change to spouse

eligibility and employee contributions.

- **Insurance Carrier Rates.** Using spousal surcharges and eligibility restrictions in an employer's insured medical plan may affect the insurer's underwriting assumptions and impact the plan's premium rates. Employers must work with their carriers before changing their plan rules.

Employers looking to lower their health plan costs through a spousal surcharge or carve-out provision should work with their insurance agent, legal counsel, and tax advisor for a more detailed analysis of the impact on their health plan.