



# Health Care Reform

## LEGISLATIVE BRIEF

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## Paying Premiums for Individual Health Insurance Policies Prohibited

Due to the rising costs of health coverage, some employers have considered helping employees pay for individual health insurance policies instead of offering an employer-sponsored group health plan. In response, on Sept. 13, 2013, the Internal Revenue Service (IRS) issued [Notice 2013-54](#) to address how the market reforms under the Affordable Care Act (ACA) apply to health reimbursement arrangements (HRAs), cafeteria plans and other employer payment plans. Also, on May 13, 2014, the IRS issued two [FAQs](#) clarifying the consequences for employers that reimburse employees for premiums they pay for individual health insurance.

Then, on Nov. 6, 2014, the Departments of Labor (DOL), Health and Human Service (HHS) and the Treasury (Departments) issued additional [FAQs](#), clarifying that **these arrangements do not comply with the ACA's market reforms and may subject employers to penalties**. Although it was widely believed that these penalties would apply only to pre-tax arrangements, the FAQs clarify that after-tax reimbursements and cash compensation for individual premiums also do not comply with the ACA's market reforms and may trigger the excise tax penalties. This guidance essentially **prohibits all employer arrangements that reimburse employees for individual premiums, whether employers treat the money as pre-tax or post-tax for employees**.

In addition, IRS Office of Chief Counsel issued two IRS Information Letters—[Letter 2014-0037](#) and [Letter 2014-0039](#)—regarding the ability of employers to reimburse employees' medical expenses with pre-tax dollars under Section 105 of the Internal Revenue Code (Code). These letters note that, **although the ACA has not changed the tax treatment under Code Section 105 or 106, these arrangements violate the ACA's prohibition on annual limits because they reimburse medical expenses up to a fixed amount**.

According to the IRS, employers that do not want to provide group health insurance coverage, but want to help their employees with the purchase of health coverage, can provide the employee additional compensation to do so. The additional compensation would not be excluded from the employee's income under Code Section 106, and would be reported with other income and wages on the Form W-2. This is because the additional compensation would not be restricted to the payment of medical expenses.

### HEALTH REIMBURSEMENT ARRANGEMENTS

HRAs have been used by employers to help employees pay for the cost of individual insurance policies on a tax-free basis. Unlike health flexible spending accounts (FSAs) and health savings accounts (HSAs), HRAs can be used to reimburse health insurance premiums. Also, unlike an HSA, an individual does not need to be covered under a high-deductible health plan (HDHP) to participate in an HRA. This has made HRAs particularly compatible with individual health insurance policies.

Notice 2013-54 addresses how the ACA's market reforms apply to HRAs, including HRAs that are not integrated with other group health coverage, or "stand-alone" HRAs. An HRA used to purchase coverage on the individual market cannot be integrated with that individual coverage, and is considered a stand-alone HRA. Some stand-alone HRAs are not subject to the ACA's market reforms because they fall under an exception, such as retiree-only HRAs. However, beginning in 2014, stand-alone HRAs that do not fall under an exception will not be permitted due to the ACA's annual limit prohibition and preventive care requirements.

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Thus, effective for 2014 plan years, employers will not be able to offer a stand-alone HRA for employees to purchase individual coverage, inside or outside of an Exchange, without violating specific provisions of the ACA and risking exposure to severe financial penalties.

## EMPLOYER PAYMENT PLANS

In [Revenue Ruling 61-146](#), the IRS provided that if an employer reimburses an employee's substantiated premiums for non-employer sponsored hospital and medical insurance, the payments are excluded from the employee's gross income under Code Section 106. This exclusion also applies if the employer pays the premiums directly to the insurance company. This IRS guidance allowed an employer to pay an employee's premiums for individual health insurance coverage without the employee paying tax on the amount.

Notice 2013-54 referred to this type of arrangement as an "employer payment plan." An employer payment plan appears to also include any tax-advantaged arrangement to pay for individual health insurance premiums, including employee pre-tax salary reduction contributions paid through a cafeteria plan.

Similar to the guidance for HRAs, Notice 2013-54 provides that an employer payment plan that reimburses employees for their individual insurance policy premiums will not comply with the ACA's annual limit prohibition and preventive care requirements. Thus, effective for 2014 plan years, these plans will essentially be prohibited.

If an employer offers a group health plan that satisfies the market reforms by providing coverage for essential health benefits without annual limits and, in addition, offers an arrangement to pay for other medical expenses, Notice 2013-54 allows the group health plan to be combined with the arrangement to determine if it satisfies the market reforms. However, if the employer does not offer a group health plan—such as when the employee is covered by an individual health insurance—the arrangement to pay the premiums cannot be combined with any other coverage to determine if it satisfies the market reforms.

IRS Notice 2013-54 did not change the tax results described in Revenue Ruling 61-146. Section 106 excludes these payments as payments by an employer under a group health plan, because the reimbursement arrangement itself is treated as a group health plan. As a group health plan, the arrangement must meet market reform rules for group health plans, including not providing a limit on the annual or lifetime benefits that the employee may receive under the arrangement (such as a reimbursement limit equal to the premiums paid).

According to the IRS, employers that do not want to provide group health insurance coverage, but want to help their employees with the purchase of health coverage, can provide the employee additional compensation to do so. The additional compensation would not be excluded from the employee's income under Section 106, and would be reported with other income and wages on the Form W-2. This is because the additional compensation would not be restricted to the payment of medical expenses.

On May 13, 2014, the IRS issued [FAQs](#) addressing the consequences for employers that do not establish a health insurance plan for their own employees, but instead reimburse those employees for premiums they pay for health insurance (either through an Exchange or outside of an Exchange). Because these employer payment plans do not comply with the ACA's market reforms, the IRS indicated in the FAQs that these arrangements may be subject to an excise tax of **\$100 per day for each applicable employee** (\$36,500 per year, per employee) under Code Section 4980D.

The Departments' prior guidance suggested that an employer payment plan does not include an employer-sponsored arrangement that allows an employee to choose either cash or an after-tax amount to be applied toward health coverage. Thus, it was widely believed that premium reimbursement arrangements made on an after-tax basis would generally still be permitted.

However, [FAQ guidance](#) issued on Nov. 6, 2014, clarified that after-tax reimbursements and cash compensation for individual premiums also do not comply with the ACA's market reforms and may trigger the excise tax penalties. **This guidance essentially prohibits all employer arrangements that reimburse employees for individual premiums, whether employers treat the money as pre-tax or post-tax for employees.**

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## **Cash Reimbursements**

According to the new FAQs, an employer arrangement that provides cash reimbursement for an individual market policy is considered to be part of a plan, fund or other arrangement established or maintained for the purpose of providing medical care to employees, **without regard to whether the employer treats the money as pre-tax or post-tax for the employee**. Therefore, the arrangement is group health plan coverage subject to the ACA's market reform provisions.

The Departments stressed that these employer health care arrangements cannot be integrated with individual market policies to satisfy the ACA's market reforms. As a result, these plans will violate the ACA's market reforms, which can trigger penalties, including excise taxes under Code Section 4980D.

## **Employees with High Claims Risk**

The FAQs also clarify that an employer cannot offer a choice between enrollment in the standard group health plan or cash **only to employees with a high claims risk**. This practice constitutes unlawful discrimination based on one or more health factors, in violation of federal nondiscrimination laws.

Although employers are permitted to have more favorable rules for eligibility or reduced premiums or contributions based on an adverse health factor (sometimes referred to as benign discrimination), the Departments assert that offering cash-or-coverage arrangements only to employees with a high claims risk is **not permissible benign discrimination**.

Accordingly, these arrangements will violate the nondiscrimination provisions, regardless of whether:

- The employer treats the cash as pre-tax or post-tax for the employee;
- The employer is involved in purchasing or selecting any individual market product; or
- The employee obtains any individual health insurance.

The Departments also noted that the choice between taxable cash and a tax-favored qualified benefit (the election of coverage under the group health plan) is required to be a Code Section 125 cafeteria plan. Offering this choice to high-risk employees could result in discrimination in favor of highly compensated individuals, in violation of the cafeteria plan nondiscrimination rules.

## **CAFETERIA PLANS**

A Section 125 Plan, or a cafeteria plan, can be used by employers to help employees pay for certain expenses, including health insurance, on a pre-tax basis. The proposed cafeteria plan regulations from 2007 allow for the pre-tax payment or reimbursement of individual health insurance policy premiums under a cafeteria plan. However, the ACA changes this rule and now prohibits cafeteria plans from paying or reimbursing premiums for individual health insurance policies, effective for 2014.

The ACA's prohibition on including individual health insurance policies under a cafeteria plan applies to policies purchased on an Exchange and through the private market, as follows:

- **Exchange Coverage:** The ACA provides that individual health insurance offered through an Exchange cannot be reimbursed or paid for under a cafeteria plan. Exchange coverage may be funded through a cafeteria plan only if the employee's employer elects to make group coverage available through the Exchange's Small Business Health Options Program (SHOP).
- **Non-Exchange Coverage:** Notice 2013-54 indicates that, effective for 2014, cafeteria plans may not be used to pay premiums for individual health insurance policies that provide major medical coverage. However, it appears that this restriction does not apply to individual policies that are limited to coverage that is excepted from the ACA's market reforms, such as retiree-only coverage or limited-scope dental or vision benefits.

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Thus, effective for 2014, the tax exclusion provided through a cafeteria plan is only available when group coverage is purchased. However, Notice 2013-54 provided a transition rule for certain cafeteria plans for plan years beginning before Jan. 1, 2014. For cafeteria plans that, as of Sept. 13, 2013, operate on a plan year other than a calendar year, the restriction on purchasing individual Exchange coverage through a cafeteria plan did not apply before the first plan year that begins after Dec. 31, 2013. However, individuals were not permitted to claim a subsidy for any month in which they are covered by an individual plan purchased through an Exchange as a benefit under a cafeteria plan.

## **Code Section 105 Reimbursement Plans**

The Departments also noted in the new FAQ guidance that certain vendors are marketing products to employers claiming that, instead of providing a group health insurance plan, employers can establish a Code Section 105 reimbursement plan that works with health insurance brokers or agents to help employees select individual insurance policies allowing eligible employees to access subsidies for Exchange coverage.

The FAQs assert that these arrangements are problematic for several reasons. First, these arrangements are, themselves, group health plans. Therefore, employees participating in the arrangements are ineligible for Exchange subsidies. The mere fact that the employer is not involved with an employee's individual selection or purchase of an individual health insurance policy does not prevent the arrangement from being a group health plan.

Second, as explained in previous guidance, these arrangements are subject to the ACA's market reform provisions, including the annual limit prohibition and preventive care coverage requirement. As noted before, these employer health care arrangements cannot be integrated with individual market policies to satisfy the market reforms and, therefore, can trigger penalties, including excise taxes under Code Section 4980D.

Near the end of 2014, the IRS Office of Chief Counsel issued IRS Information Letters [2014-0037](#) and [2014-0039](#) to reiterate that these types of arrangements violate the ACA's market reform rules. In the letters, the IRS noted that the ACA has not changed the tax treatment of the reimbursement for employee medical expenses under Code Section 105. However, under the ACA these arrangements are considered to be group health plans, and therefore must satisfy the ACA's market reform rules. One of these market reform requirements is a prohibition on annual or lifetime dollar limits on essential health benefits. The IRS Information Letters noted that an agreement by the employer to reimburse medical expenses up to a fixed amount is a group health plan under which there is an annual limit on essential health benefits and, thus, fails to comply with the prohibition on annual limits.

## **MORE INFORMATION**

The Department of Labor (DOL) also issued [Technical Release 2013-03](#) on Sept. 12, 2013, which is substantially identical to IRS Notice 2013-54. In addition, the Department of Health and Human Services (HHS) issued [guidance](#) on Sept. 16, 2013, to reflect that it concurs with Notice 2013-54. On Jan. 24, 2013, the DOL and HHS also issued [FAQs](#) that addressed the ACA's application to HRAs.

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