



RECENT GUIDANCE ON CONTRIBUTING TO AN EMPLOYEE'S INDIVIDUAL HEALTH INSURANCE PREMIUM ON A TAX-FREE BASIS

As the Affordable Care Act (ACA) continues to be implemented, employers of all sizes are exploring a variety of different responses to the requirements and mandates of the law. With the advent of three important insurance reforms — guaranteed issue in the individual market, the state health insurance exchanges and possible premium subsidies for policies purchased through those exchanges — one option that some employers are exploring is dropping their group health plan altogether and directing employees to purchase their own individual health policies through the state health insurance exchange or otherwise.

Employees who are directed to purchase their own health insurance coverage are likely to continue seeking financial assistance from their employers to help offset the cost of such coverage and replace the employer contribution towards the group health plan they have now lost. While employers are under no obligation to provide such contributions, many employers will likely wish to do so, out of fairness to their employees and the business necessity of attracting and retaining the talent needed to run their organizations.

Can an employer provide financial assistance to employees to cover the cost of individual health insurance coverage on a tax-free basis? Guidance issued by the relevant federal agencies in September 2013 makes it clear that while an employer can reimburse employees for such individual policies, doing so on a tax free basis creates a significant risk of violating the ACA and the potential for significant fines and penalties. On May 13, 2014 the IRS issued a [Q and A](#) reiterating its stance.

Why are tax-free individual premium reimbursements an unworkable option?

The method by which an employer traditionally provides tax-free reimbursement for health-related expenses is either:

1. As a reimbursement for a submitted claim under Internal Revenue Code Section 105 Health Reimbursement Arrangement (HRA); or
2. In the form of direct payment through an employer payment plan under Code Section 106.

No annual limits. The IRS states contribution/reimbursement arrangements born under Code Section 105 and/or 106 are subject to ACA market reforms, including the prohibition on annual limits for essential health benefits (EHBs). The IRS determined that the contribution of money to fund the cost of premiums for individual health plans (or, the reimbursement of such cost) is considered to be an EHB. As a result, providing the tax-free contribution or reimbursement of the cost of individual premiums to employees for a set amount automatically violates the “no annual limit” requirement.

First dollar coverage. The ACA also calls for Section 105 and 106 health plans to provide 100% of the cost of preventive care. The HRA or the employer payment plan would naturally not be integrated with individual health policies that are being funded by the reimbursement arrangement. This means that the reimbursement arrangement cannot rely on the benefits provided by the individual policy to meet its own obligations under the ACA.



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So, for example, the fact that an employee's individual policy may pay for the full cost of preventive care without cost sharing does not relieve the premium reimbursement arrangement itself from having to provide 100% preventive care. As a result, the HRA or employer payment plan would not be able to meet this ACA obligation.

What are the penalties if tax-free reimbursements for individual premiums are provided?

Under Section 4980D of the Internal Revenue Code, the IRS has the authority to penalize plans for failing to comply with ACA market reforms, such as the two discussed above. Excise taxes may be as much as \$100 per day per applicable employee (which is \$36,500 per year per employee). Additionally, the value of the reimbursements would be rendered taxable to the employee recipient, thereby creating an adverse tax situation for the employees seemingly benefiting from such an arrangement.

What about using a cafeteria plan to provide tax-free individual premium contributions?

First of all, the ACA explicitly prohibits premiums for individual policies purchased through a public insurance exchange from being paid using a cafeteria plan. This pretty much shuts the door on using a cafeteria plan as a vehicle for tax-free contributions for individual policies. However, the ACA does not specifically have the authority to mandate the use of a cafeteria plan for payment of

individual policies purchased outside a public exchange. While the IRS has long permitted individual policies to run through a cafeteria plan, it has done so because such premiums qualify for the exclusion under Code Section 106. As a result, the ACA market reforms to which the HRA and employer payment plan are subject would apply to the cafeteria plan as well – thereby rendering the cafeteria plan as an unrealistic tax-free solution.

In summary, an employer may increase an employee's taxable compensation as a means to help them pay the cost of individual premiums. However, the IRS is clear that trying to do so in a tax-free manner will subject the employer to significant excises taxes and potentially other penalties for what would look to be willful violation of ACA mandates. Associated Financial Group wants to remind employers that cafeteria plans and HRAs, when properly constructed ([read more](#) on this topic), can still serve as valuable tools in offering competitive and cost-effective employee benefits.

Please contact your Associated Financial Group consultant for more information about how HRAs can be used to attract and retain talent in the future. Employers seeking to reimburse the cost of individual premiums in a tax-free fashion should contact their legal counsel and/or tax advisor immediately for a formal opinion of the risks associated with continuing down this prohibited path.

To view our full list of healthcare reform webinars, [click here](#). For more information contact us at 800-258-3190 or info@AssociatedFinancialGroup.com.



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