

It's Time to Stop Reimbursing Employees on a Tax-Free Basis for Individual Health Insurance Premiums

By Susan Richards Salen

Prior to the Affordable Care Act (“ACA”), employees of small employers¹ which did not offer group health insurance benefits has to find expensive individual health plans. In order to compete with large employers and to offer employees with some health insurance benefit, many of these employers offered to reimburse employees on a tax-free basis for costs that the employee incurred in obtaining health insurance on their own. These payments were made through a health reimbursement account, by a direct payment to the insurance company or with health Flexible Spending Arrangements and were provided to the employee on a tax-free basis. An employer that offers a group health plan to its employees may continue to offer a tax-free reimbursement of health insurance premiums or offer the ability of the employee to pay the premium tax free. Tax-free reimbursement programs for individual health plans were made illegal under IRS Notice 2013-54 as of January 1, 2014. However, an enforcement extension was granted up until July 1, 2015 under IRS Notice 2015-17. Further, if the employer is an S Corporation, it may continue to report reimbursements for health insurance of two percent (2%) shareholders until further guidance is issued by the IRS or the end of 2015, whichever comes first. Any employer that continues to pay employees using the tax-free reimbursement programs or reimbursement programs tied to payments for premiums for individual health plans or medical cost reimbursements after June 30, 2015 are subject to a \$100 per day excise tax per applicable employee.

The rationale behind this prohibition is that an employer reimbursement plan or tax-free premium benefit plan is considered a group health plan subject to the market reforms of the ACA. Included within these market reforms is the prohibition of annual dollar limits for essential health benefits and a requirement to provide certain preventative care without cost sharing. Since a reimbursement program or tax-free premiums are limited by the amount of payments the employer would make in a year, these types of plans do not satisfy the market reform of no annual dollar limit and they do not provide preventative care without cost sharing.

Small employers should increase compensation for employees to whom it was offering this benefit instead of offering to pay employees for a “substantiated premium” for non-employer sponsored hospital and medical insurance. This means that a small employer may provide its employees with additional cash compensation, which will be subject to employment taxes, but cannot tie this amount to a specific premium reimbursement or medical costs of the employee.

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¹ A small employer under the ACA is an employer with less than 50 employees.

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