

## EMPLOYEE BENEFITS

### **EMPLOYER PAID INDIVIDUAL HEALTH INSURANCE POLICIES CREATE THE POTENTIAL FOR SIGNIFICANT PENALTIES, BUT LIMITED RELIEF IS AVAILABLE**

by *Eric W. Gregory*

Despite guidance from the Internal Revenue Service ("IRS"), the Department of Labor ("DOL") and the Department of Health and Human Services ("HHS") indicating the prohibition of the practice under the Affordable Care Act ("ACA"), some employers continue to reimburse employees for health insurance premiums. This practice could lead to thousands of dollars in penalties.

Notice 2015-17 is the IRS' most recent guidance on such arrangements, reaching the same conclusions. It also, however, provides welcome penalty relief for certain employers.

#### **Background**

Due to the high cost of group health coverage, some employers prefer to offer what has come to be known as "Employee Payment Plans" ("EPPs"). Through these plans, employers encourage employees to purchase their own individual health insurance and then reimburse them for some or all of the cost of the premiums.

This practice has long-standing precedent. In 1961, the IRS released Revenue Ruling 61-146, holding that premium subsidies could be provided to employees on a pre-tax basis so long as either the employer paid the insurance company directly or reimbursed the employee for the cost of the coverage. The payments could be excluded from the employee's gross income under Internal Revenue Code ("Code") Sections 105 and 106.

#### **The ACA Market Reforms and Notice 2013-54**

The enactment of the ACA did not directly prohibit EPPs, but enacted market reforms that apply to "group health plans." In 2013, the IRS issued Notice 2013-54, taking the position that an EPP that reimburses employees for individual insurance policy premiums is a "group health plan" and must satisfy these market reforms.

Among other things, the market reforms in the ACA establish that group health plans may not contain an annual limit on the amount of benefits for an individual. Notice 2013-54 clarifies that an EPP is considered to impose an annual limit up to the cost of the coverage purchased.

The impact of violating an ACA market reform is considerable. Code Section 4980D(b)(1) provides for a \$100 per day, per employee penalty (subject to certain caps with respect to unintentional failures). ACA violations are self-reported by an employer on IRS Form 8928.

#### **The Impact on S Corporations**

S corporations are particularly affected by this change. The Code looks at ownership percentages of S corporation shareholders (similar to the treatment of partners in a partnership) for the treatment of certain fringe benefits. A more than 2-percent owner of an S corporation is not entitled to receive tax-free fringe benefits.

Therefore, when an S corporation would reimburse a more than 2-percent owner for premiums or pay them on the owner's behalf, the owner could not exclude that amount from taxable income. Instead, as explained in IRS Notice 2008-1, the owner would include those amounts in taxable compensation but deduct the premiums as a "self-employed health insurance deduction." The S corporation could deduct the reimbursements as compensation.

Now, such arrangements are in contravention to the ACA market reforms and can trigger the penalty discussed above.

#### **DOL FAQ Part XXII**

In November 2014, the DOL, HHS and the IRS jointly released FAQ Part XXII on the Affordable Care Act, further limiting the ability for employers to reimburse employees for premium payments. Q&A #1 states that an EPP violates ACA market reforms whether the payment is treated as pre-tax or post-tax to the employee.

#### **Transitional Relief for Small Employers and S Corporations under Notice 2015-17**

Transitional relief applies to some plans other than those sponsored by an Applicable Large Employer ("ALEs") under Notice 2015-17. An ALE, for a particular calendar year, has an average of 50 or more full-time employees during the preceding calendar year.

If an employer was not an ALE for 2014, no Code Section 4980D tax is assessed in 2014 for failure to satisfy ACA's market reforms that would otherwise arise from having offered an EPP used to pay or reimburse employees for individual health insurance premiums or Medicare Part B or Part D premiums. If an employer is not an ALE for 2015, this exemption from the Code Section 4980D tax is extended through the period of January 1 through June 30, 2015.

Additionally, until further guidance is issued (but at least through the end of 2015) employers will not be assessed the Code Section 4980D tax for failure to satisfy the ACA's market reforms that would otherwise arise from having offered an EPP that is an S corporation healthcare arrangement for 2% shareholder-employees.

#### **Special Rules Regarding Medicare/TRICARE Reimbursement under Notice 2015-17**

Notice 2015-17 confirms that arrangements that reimburse employees for Medicare or TRICARE premiums may be group health plans subject

to the ACA market reforms. However, so long as employees enrolled in Medicare Part B, Part D or TRICARE are offered employer health plan coverage that is of minimum value and not solely excepted benefits, they can also be offered a premium reimbursement arrangement to assist them with the payment of the Medicare or TRICARE premiums. Employers should remain cautious, however, about offering financial incentives for employees to obtain Medicare or TRICARE coverage because of prohibitions on that practice in the Medicare Secondary Payer Act.

### Solutions for Other Employers That Have Violated ACA's Market Reforms

Under Code Section 4980D, the IRS may waive part of or the entire tax for a failure due to "reasonable cause" and not "willful neglect." The IRS has not defined the terms "reasonable cause" or "willful neglect" in the context of the Code Section 4980D tax. Generally under the Code, reasonable cause can describe a scenario where a compliance failure occurs notwithstanding the exercise of ordinary business care and prudence. Willful neglect, on the other hand, generally implies a conscious, intentional failure, or reckless indifference to the market reform at issue.

Therefore, it may be wise to report the failure to the IRS on Form 8928, along with an explanation of why the failure occurred. If the error is not self-reported and is discovered by the IRS, the penalty rises to a minimum of \$2,500 per individual affected by a violation.

### Solutions for the Future

Small employers with 50 or fewer employees can provide a group health plan through the Small Business Health Options Program ("SHOP") Marketplace Exchange. These plans can be used in conjunction with a Code Section 125 cafeteria plan to permit an employee's share of individual premiums to be offered on a pre-tax basis.

For larger employers, permissible solutions include either establishing a group health plan that meets the market reform requirements or stopping reimbursements. Additionally, it may be possible to offer employees additional compensation without any requirement that the employee use the amount to cover insurance premiums, a practice that the IRS sanctions in Notice 2015-17.

Keep in mind, however, that the ACA's employer mandate has already come into effect for employers with more than 100 full-time (and full-time equivalent) employees and will apply to those with 50 or more next year. In 2015, employers will need to offer minimum essential coverage to at least 70% of their full-time employees to avoid an employer level penalty under Code Section 4980H, and to 95% of full-time employees by 2016.

Finally, Notice 2015-17 makes it clear that the market reform rules do not apply to EPPs that only have one participating employee. When considering the possibility of operating a one-employee

EPP for employers with more than one employee, however, the nondiscrimination rules under Code Section 105(h) should be carefully reviewed.

Dickinson Wright's employee benefits practice team will continue to follow developments in this area. The IRS anticipates releasing additional guidance in the future. Please contact the author of this Alert, any member of the employee benefits practice team or your regular Dickinson Wright attorney for guidance.

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