

# Employee Benefit Adviser

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## Premium reimbursement is a costly violation

The Internal Revenue Service, Department of Labor and Department of Health and Human Services have each issued frequently asked questions stating that employer payment plans (sometimes referred to as premium reimbursement plans) for individual health insurance coverage fail to comply with the Affordable Care Act. Employers that violate this rule are subject to an excise tax of up to \$100 per day (\$36,500 per year) for each affected employee.

An employer payment plan is an arrangement in which an employer reimburses employees or pays directly for all or part of the premium for individual coverage. These employer payment plans are considered to be group health plans that do not comply with the requirements of the ACA. An employer cannot reimburse employees for the purchase of an individual market policy, regardless of whether the employer treats the payment as a tax-free benefit or as additional taxable wages to the employee.

*For example:* Company A has seven employees and reimburses each employee for the cost of his or her individual health insurance premium. Beginning July 1, 2015, the continuation of this policy exposes Company A to a \$255,500 annual excise tax (\$36,500 tax for each of the seven full-time employees), regardless whether the reimbursement to the employees is with pre-tax or after-tax dollars.

### Temporary relief for small employers

Earlier this year, the IRS issued Notice 2015-17, which provided transition relief from this \$100-per-day excise tax. In the notice, the IRS recognized that many small employers provide health coverage by paying directly or reimbursing the cost of premiums for individual policies, and outlined the relief as follows:

Small employers with fewer than 50 full-time employees (for at least six consecutive months) will not be subject to the penalty for either 2014 or for the period January 1, 2015, through June 30, 2015. This means, however, that small employers are now "on the clock" to fix this payroll practice before the middle of 2015.

All hope is not lost for small employers that have this type of arrangement with their employees. Employers have the right to provide compensation increases to their employees. So long as the employer does not require that an employee use the increase to purchase health coverage, an employer payment plan is not created.

The extra pay will be subject to income and payroll taxes. The employee can do whatever he or she pleases with this extra pay, whether that includes or does not include purchasing an individual health insurance policy.

A second payroll practice exception may be available for employers with employees who maintain their own individual coverage. Employers may forward post-tax employee wages to the health insurance carrier at the direction of the employee. This arrangement should not constitute an employer payment plan.

### No similar relief for large employers

The transition relief does not apply to employers with more than 50 full-time employees or to standalone health reimbursement arrangements. Large employers in violation of the law are required to file Form 8928 and report the excise tax.

This excise tax may be waived (or reduced) if the employer can show reasonable cause for its failure to comply with the ACA, or demonstrate that its failure was not due to willful neglect. It remains to be seen how generous the IRS will be in waiving or reducing this excise tax.

### Relief for shareholders

Notice 2015-17 also provides transitional relief to shareholders who own more than 2% of an S corporation. Pending further guidance — and at least until the end of 2015 — these shareholders may continue to deduct any individual health insurance premiums reimbursed by the S corporation on their Form 1040 as self-employed health insurance premiums. Also, an S corporation that only covers one employee is generally not subject to the ACA.

### Cash incentives not an option

An employer cannot offer employees with high claims risk the following choice: enrollment in its group health plan or cash. An employer cannot provide a cash incentive to high-risk employees to encourage them to waive coverage on the employer's plan and instead purchase individual health insurance, whether on the exchange or in the private market.

The DOL considers this practice discrimination against individuals based on health status, and holds it out as a violation of the Employee Retirement Income Security Act and Health Insurance Portability and Accountability Act rules.

### Take action before June 30

Small employers that reimburse employees or pay directly for all or part of employees' premiums for individual health coverage have a short window of opportunity to change this practice. Employers should take advantage of this transition relief and seek other ways of contributing to employees' health care costs.

*Anspach, Jr. is a principal at Much Shelist and leads the law firm's employee benefits practice. The information in this legal alert is for educational purposes only and should not be taken as specific legal advice.*

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