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Important Update on Employer Health Insurance Premium Reimbursement/ Payment Plans

Issue at a Glance

For many years, employers were able to directly pay for, or reimburse employees for, the premiums of health insurance policies purchased by an employee without the employee being taxed. These are referred to in this Alert as "premium reimbursement plans." This option has been particularly popular among smaller employers and those with employees working away from the main office.

This favorable treatment changed effective January 1, 2014. **Employers offering premium reimbursement plans are not complying with the Affordable Care Act (ACA), and may be subject to penalties of $100 per day, per participating employee.** That would add up to $36,500 a year per employee covered for the whole year.

More recently, on February 12, 2015, the Evangelical Council for Financial Accountability (ECFA) provided a webinar, seen by many, that explained the issues and recommended a course of action. On February 18, the IRS issued Notice 2015-17 (2015-10 IRB, 2/18/15), which provides long-needed guidance and modifies the advice from the ECFA webinar in some respects.

Employers offering this kind of health benefit should take action:

1. All employers should stop offering premium reimbursement plans as soon as possible.
2. Large employers (those with 50 or more full-time equivalent employees) should consider filing Form 8928, which may provide relief from the penalty. (More on this below.)
3. Enforcement against small employers (those with fewer than 50 full-time equivalent employees) has been delayed until at least July 1, 2015.

Understanding the Issue

The favorable tax treatment for employee premium payment plans was established in 1961 with Revenue Ruling 61-146. Essentially, as long as the employee was reimbursed for the premium he or she paid for the purchased plan, or the employer directly paid the premium for the employee's purchased plan, the employee was not taxed.

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The implication of the ACA for premium reimbursement plans was not immediately clear. The IRS first addressed this in September, 2013, in Notice 2013-54. The Notice (and an earlier Department of Health and Human Services interpretation) treats premium reimbursement plans as group health plans subject to all of the requirements for group health plans established by the ACA. A premium reimbursement plan does not comply with the group health plan requirements.

Consequently, beginning January 1, 2014 an employer offering a premium reimbursement plan may be subject to a penalty of $100 per day, per participating employee for offering a non-compliant health plan.

Please note:

- Employer-purchased group health plans are not affected by this change. It only applies to individual policies purchased by employees.
- This law change is being applied to employers with fewer than 50 employees, as well as larger employers. There is no exception for churches or other religious organizations.
- An employer's health plan that only covers one employee, however, is exempt from the ACA requirements. Consequently, employers in this situation can still reimburse that employee's premium, tax-free.

In Notice 2015-17, the IRS effectively acknowledged the scope of disruption this change has caused to small employers, and provided needed guidance:

- As transition relief for small employers, the IRS will not enforce the penalty on small employer premium reimbursement plans in 2014 and through June 30, 2015. For this purpose, a small employer is an employer that is not an Applicable Large Employer (ALE; see below for definition). This relief is automatic; the small employer does not have to file anything to take advantage of it.
- There is no specific relief for Applicable Large Employers. Generally, an ALE is an employer that employed an average of at least 50 full-time-equivalent employees on business days during the preceding calendar year. See below regarding the possible benefit of filing Form 8928 if an ALE made payment of premium reimbursements.

In addition to the transition relief for small employers, the IRS also clarified several other uncertainties:

- An employer with a group health plan may integrate reimbursement (or make direct payment) of premiums for active employee coverage under Medicare Parts B and D. For active employees, payment of Medicare premiums must comply with Medicare secondary payer provisions.
- An employer may have a retiree health plan that reimburses (or makes direct payment) of Medicare Part B and D premiums for retired employees, regardless of whether it is integrated with a group health plan.

Tax Division
407.883.4671

Atlanta
678.518.5301

Boston
617.535.7534

Chicago
630.682.9797

Colorado Springs
719.528.6225

Columbia
803.458.2169

Dallas
817.328.6510

Denver
720.283.7326

Grand Rapids
616.717.5764

Indianapolis
317.885.2620

Los Angeles
714.961.9300

New York
212.653.0681

San Diego
619.955.5333

San Francisco
925.201.1187

- The exemption from income tax for premium reimbursement/payment plans under Revenue Ruling 61-146 continues to apply. This exempts the premium for a one-employee plan, and also exempts other premium reimbursements, even though they are not in compliance with the ACA and therefore subject to the penalties.
- An employer may increase taxable compensation to an employee to help the employee pay the employee's insurance premiums without being subject to the penalty, as long as the increased pay is not conditioned on the employee's purchasing insurance.

Action Points

Now is the time to fix premium reimbursement plans for 2015. **If your organization has started the year reimbursing premiums, stop as soon as possible.** In light of the delayed enforcement by the IRS until July 1, 2015, a small employer may take some time to develop a strategy that helps their employees.

ALEs that have reimbursed or paid premiums do not have the delayed enforcement granted to small employers. But relief from penalties may be available by filing Form 8928 and claiming exemption from the penalty. Note that:

1. An employer can claim the exemption if the failure to comply with the requirements "was due to reasonable cause and not due to willful neglect and the failure was corrected during the 30-day period beginning on the first date anyone liable for the tax knew, or exercising reasonable diligence would have known, that the failure existed" (per Form 8928 instructions).
2. The 30-day correction period does not allow much time to stop the premium reimbursement plan.
3. For many employers, the slow pace of providing guidance and lack of clarity in the IRS guidance provided may constitute reasonable cause and lack of willful neglect.
4. Stopping the reimbursement process is sufficient correction, since it is not feasible to "undo" a reimbursement once it has occurred.

Cautions

There continue to be many areas that are unclear, including possibly some variations on the guidance provided above for specific employer or employee situations. In addition, Congress may change the law, the Supreme Court may invalidate the law, or the IRS may adjust its interpretation of the law at any time. Careful attention to these issues must continue. We will provide updates as more information becomes available.