



Prohibited Employer Health Insurance Premium Reimbursement Arrangements – *Immediate Action Required*

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Understandably, the general focus on the Affordable Care Act (“ACA”) the last few years has been on ACA constitutionality, the employer and individual mandates, operation of the ACA health insurance exchanges (the “Health Insurance Marketplace” or “Marketplace”) and premium tax credits thereunder, and the impact of the ACA on provider networks. Employers, however, should be aware that Internal Revenue Service (“IRS”) and other U.S. government agency guidance has struck down a previously benign practice that employers (particularly small ones) have used to provide health insurance coverage to a limited number of valuable employees (e.g., when the employer does not otherwise offer employees group health coverage): Reimbursements to employees who purchase their own health insurance.

Historically, such reimbursement arrangements (referred to as “**employer payment plans**”) were a not uncommon practice of employers through which the premium reimbursements could be made on an income tax-free basis to an employee. Effective January 1, 2014, however, any such arrangements (even if done on an after-tax basis) subject an employer to a **steep excise tax** under the ACA (**\$100 per day for each affected individual**), except in the case of certain small employers for a limited transition period (discussed below) that the IRS announced earlier this year. As a result, this is a practice that employers must end (e.g., no more agreeing to such one-off reimbursement arrangements for new physicians brought into a practice group, for U.S. employees hired by foreign corporations for company outposts in the U.S., etc.).

What Premium Reimbursement Arrangements are Prohibited?

IRS guidance is clear that regardless of whether an employer reimburses an employee on a tax-free or on an after-tax basis for the employee’s purchase of insurance (via the Health Insurance Marketplace or otherwise), or whether the employer pays the employee’s individual insurance premiums directly rather than via reimbursement, such employer payment plans are considered group health plans that are subject to ACA health insurance market reforms. Furthermore, an employer cannot integrate an employer payment plan with the employee’s individual insurance policy to satisfy the health insurance market reform requirements. As a result, any employer payment plan inevitably fails to satisfy certain ACA requirements applicable to group health plans, such as (i) the ACA annual limit on out-of-pocket expenses and (ii) mandated cost-free coverage for preventative services. This ACA failure subjects the employer to a nondeductible excise tax under the Internal Revenue Code of \$100 for each day of the plan’s noncompliance (i.e., each day the plan is in effect) for each applicable employee covered by the plan (e.g., \$36,500 per person per year).

Transition Relief for Small Employers through June 30, 2015

The IRS (pursuant to recent IRS Notice 2015-17) has provided transition relief through June 30, 2015, for employer premium reimbursement arrangements of employers that are not “applicable large employers” under the ACA. An applicable large employer (“ALE”) generally is an employer that employed an average of at least 50 full-time (including full-time equivalent) employees during the preceding calendar year. (For 2014 and 2015, an employer alternatively may determine whether it is (or is not) an ALE based on a period of 6 or more consecutive months in the preceding calendar year, rather than the entire preceding year.)

An employer that is not an ALE for 2014 is not subject to an excise tax for 2014 for any failure to satisfy ACA health insurance market reform requirements by maintaining any employer payment plan described above. Similarly, an employer that is not an ALE for 2015 is not subject to any excise tax from January 1, 2015 through June 30, 2015, for any failure to satisfy ACA reform requirements for any such employer payment plan. Beginning July 1, 2015, there is no such excise tax relief, however.

Is there an Alternative that is Permitted?

An employer is permitted under the ACA to simply increase an employee's compensation without conditioning the payment of the additional compensation on the purchase by the employee of (or the reimbursement for) individual health insurance policy coverage; provided the employer does not otherwise endorse any particular policy, form or issuer of health insurance. Such a "no-hands-tied" compensation arrangement would not be a group health plan subject to the ACA health insurance market reforms (and simply providing employees with information about the Health Insurance Marketplace, or premium tax credits under the Marketplace, would not be considered endorsing any particular policy, form or issuer of health insurance). So an employer may provide a taxable increase in an employee's compensation that the employee can use to purchase an individual health insurance policy, but the employer should clearly communicate and document that the employee may use the increase for any purpose the employee so chooses.

In addition, an employer reimbursement arrangement covering only a single employee generally is not subject to the ACA health insurance market reform requirements, but if an employer maintains more than one such arrangement (for different employees), all such arrangements are treated as a single arrangement covering more than one employee. So an employer with separate reimbursement arrangements with 2 or more employees would be treated as having a group health plan subject to the reform requirements and excise tax.

Finally, until further guidance is issued (and at least through the end of 2015), the IRS will not assert an excise tax for failure to satisfy any ACA health insurance market reforms for an arrangement whereby an S corporation pays for or reimburses premiums for individual health insurance coverage for shareholders who own more than 2 percent of an S corporation.

Reimbursements of Medicare and TRICARE Premiums

Briefly, it should be noted that IRS Notice 2015-17 also provides that an arrangement under which an employer reimburses (or pays directly) Medicare Part B or Part D premiums for employees, or medical expenses for employees covered by TRICARE (i.e., U.S. military health care coverage), is an employer payment plan that is a group health plan subject to the ACA health insurance market reforms if it covers 2 or more employees. Such arrangements cannot be integrated with Medicare or TRICARE coverage to satisfy ACA reform requirements, but potentially may be integrated with another group health plan offered by the employer to satisfy such requirements.

What Should Employers do Now?

There still is time for eligible small employers to eliminate any applicable employer payment plans and avoid the harsh excise taxes that otherwise will apply to them beginning July 1, 2015. Employers should immediately arrange to stop these prohibited arrangements and modify any affected employment contracts. Also, in the case of an applicable large employer with an employer payment plan, time is of the essence to eliminate any such arrangement in order to cut off any accruing excise tax exposure.

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