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Dear Client:

For plan years beginning after 2013, the Affordable Care Act (ACA) institutes so-called market reform provisions that place a host of new restrictions on group health plans. The penalty for violating the market reform restrictions is a punitive $100-per-day, per-employee penalty, or $36,500 per employee, per year. With a limited exception, these new market reform provisions significantly restrict an employer's ability to reimburse employees for premiums paid on individual health insurance policies, referred to as employer payment arrangements.

Employer Payment Arrangements

Under employer payment arrangements, the employer reimburses the employee for premiums he/she pays on his/her individual health insurance policy (or the employer sometimes pays the premium on behalf of the employee). As long as the employer (1) makes the reimbursement under a medical reimbursement plan and (2) verifies the reimbursement was spent only for insurance coverage, the premium reimbursement is excludable from the employee's income. These arrangements have long been popular with small employers wanting to offer health insurance but unwilling or unable to purchase group health coverage.

Unfortunately, according to the Internal Revenue Service (IRS) and Department of Labor (DOL), group health plans cannot be integrated with individual market policies to meet the new market reform provisions. Furthermore, according to the DOL, an employer that reimburses employees for the individual policies (on a pretax or after-tax basis) has established a group health plan, because the arrangement's purpose is to provide medical care to its employees. Therefore, reimbursing employees for premiums paid on individual policies violates the market reform provisions, potentially subjecting the employer to a $100-per-day, per-employee ($36,500-per-year, per-employee) penalty.

Limited Exception for One-Employee Plans

The market reform provisions do not apply to group health plans with only one participating employee. Therefore, it is still allowable to provide an employer payment arrangement that covers only one employee. Note, however, nondiscrimination rules require essentially all fulltime employees must participate in the plan.

Bottom Line

While still technically allowed under the tax code, employer payment arrangements, other than arrangements covering only one employee, are no longer a viable alternative.

Acceptable Alternatives

Because of the ACA market reform requirements, employers are essentially precluded from subsidizing or reimbursing employees for individual health insurance policies in which there is more than one employee participating in the plan. Employers can, however, do any of the following:

- Provide a tax-free fringe benefit by purchasing an ACA-approved employer-sponsored group health plan. Small employers with 50 or fewer employees can provide a group health plan through the SHOP Marketplace. A cafeteria plan can be set up for pretax funding of the employee portion of the premium.

- Increase the employee's taxable wages to provide funds the employee may use to pay for individual insurance policies. However, the employer cannot require the funds be used to pay for insurance—it must be the employee's decision to do so (or not). The employer can claim a deduction for the wages paid. The wages are taxable to the employee, but the employee can claim the premiums as an itemized deduction subject to the 10-percent-of-AGI limit (7.5 percent if age 65 or older).

In Conclusion

If you, as the employer, are directly or indirectly paying for an employee's individual health insurance premiums, please call us to discuss alternatives to initiate before year-end to reduce the risk of incurring these severe penalties.

Sincerely,

HEINOLD BANWART, LTD.