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Frequently Recurring Questions Regarding the Impact of the Affordable Care Act on Employers: Part I

Since the passage of the Affordable Care Act, many of the questions we have received from our clients focus on tricky issues that arise repeatedly with employers both large and small. To help employers navigate the often rough regulatory terrain of federal health care reform, we thought it would be useful to draft a series of Alerts containing some of the most common questions we have received and our answers to them. This Alert is the first out of the gate.

Employer Reimbursement of Premiums

Q-1: Rather than sponsoring its own group health plan for employees, can an employer reimburse employees' premiums for health care coverage that they have obtained elsewhere?

A-1: In general, no. With only a few exceptions (see Q&A #3 below), this type of practice is now prohibited and will subject the employer to excise taxes under the Internal Revenue Code of $100 per day (or $36,500 per year) per affected employee. Here's why:

If the employer is reimbursing its employee's premiums under an individual health plan (as opposed to a group health plan), the IRS treats the reimbursement arrangement itself – which the IRS characterizes as an "employer payment plan" – as a type of "group health plan." This means that the reimbursement arrangement would be subject to the various market reforms that are mandated by the Affordable Care Act (e.g., prohibition on annual limits, preventive services must be provided without cost sharing, etc.) By its very nature, an employer payment plan cannot comply with these market reforms. Its establishment, therefore, would subject the employer to draconian excise taxes.

Q-2: Wait, I thought the IRS allowed employers to reimburse employees' premiums under some individual health care plan without the reimbursement being taxable to the employee?

A-2: Technically, the IRS still allows an employee's premiums under an individual health insurance policy to be reimbursed by the employer on a tax-free basis. The IRS Revenue Ruling from 1961 that allowed this remains in effect. But now, such an arrangement also triggers substantial excise taxes to the employer. Effectively, then, the arrangement is now prohibited in most circumstances.

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Q-3: Are there any exceptions under which an employer could reimburse its employees' premiums for health care coverage not being offered by that employer?

A-3: There are some limited exceptions, although employers must tread very carefully:

- For example, an employer could establish an arrangement under which it allows employees to choose between cash or an after-tax amount to be applied towards the employee's health insurance coverage. This would not be considered an "employer payment plan" and thus would not trigger any excise taxes. Instead, this sort of arrangement would be treated by the IRS as an approved "payroll practice" under which the employer is merely forwarding – at its employee's request – the employee's after-tax wages to the employee's health insurance issuer.

- An employer also could establish a Health Reimbursement Arrangement ("HRA") that is "integrated" with a group health plan. (With very limited exceptions, an HRA cannot be integrated with an individual health plan.) The integration requirements can be tricky depending on what type of group health plan the HRA is integrated with. But assuming the integrated group health plan provides "minimum value," the employer could contribute money to the employee's HRA, which in turn could be used to pay health care premiums under the group health plan in which the employee is enrolled.

  The integrated group health plan doesn't actually have to be sponsored by the employer making the contributions to the HRA; it could be sponsored by some other employer (e.g., the employee's former employer, or the employee's spouse's employer) so long as (i) the employee is actually participating in the group health plan, and (ii) the other group health plan satisfies all of the market reforms under the Affordable Care Act. So, for example, if an employee declines coverage in his own employer's group health plan because he is enrolled in a group health plan through his wife's employer, that employee could still receive contributions in the HRA sponsored by his own employer. This sort of arrangement probably doesn't benefit the employer much, but it is permissible.

- An employer also could reimburse its employee's premiums under some other group health plan (e.g., the employee's COBRA premiums under the group health plan of the employee's former employer). The reason for this is that recent IRS guidance suggests that its restrictions on employer payment plans are confined to situations in which "an employer reimburses an employee for some or all of the premium expenses incurred for an individual health insurance policy or directly pays a premium for an individual health insurance policy covering the employee."

Q-4: If an employer agrees to pay the COBRA premiums of a (now former) employee following that employee's termination of employment (through, for example, a severance agreement), would that type of arrangement trigger any excise taxes?

A-4: No, for the same reasons described in the final bullet point of Q&A #3 above.

Permissibility of Offering Higher Salary for Waiver of Benefits

Q-5: Can an employer offer its employees a higher salary if they agree not to enroll in the employer's group health plan?

A-5: This is a very tricky issue. The only way that an employer can legally offer an employee a choice between cash and a non-taxable benefit (such as health care coverage) is through a cafeteria plan under Section 125 of the Internal Revenue Code. If an employer provides such an election to an employee but does not do so through a valid cafeteria plan, then the amount of the cash offered is included in the employee's gross income, even if the employee opted for the non-taxable benefit. (For example, in the absence of a cafeteria plan, if an employee was offered a choice between $5,000 or subsidized health care coverage in the employer's medical plan, the employee would have an extra $5,000 included in his/her gross income for the year, even though he/she elected the medical coverage rather than the $5,000.)

Furthermore, the DOL has stated that, if this option of receiving higher pay for declining coverage in the employer's group health plan is only extended to employees with high claims risk, the employer will be in violation of HIPAA's prohibition on discrimination based on health status.

If an employer is dead-set on adopting this type of arrangement, there may be other ways to skin this cat. But it is imperative that an employer consult with experienced benefits counsel before proceeding. The consequences of traveling down this path without solid legal guidance could be incredibly expensive for both the employer and the affected employees alike.

Permissibility of Offering Better Benefits to Executives

Q-6: Can an employer provide higher health care premium subsidies to company executives than it provides for its rank and file employees?

A-6: Maybe. The Internal Revenue Code imposes non-discrimination rules on self-insured group health plans that limit an employer's ability to offer better benefits (including richer subsidies) to its higher-paid employees. The rules are complex and require careful analysis to determine if a particular plan offering different benefits would pass the test.

If, on the other hand, the employer's group health plan is fully-insured, then there are no non-discrimination rules that apply to the plan itself as of now. (In the Affordable Care Act, Congress directed the IRS to issue regulations applying non-discrimination rules to fully-insured plans, but the issuance of those regulations has been indefinitely delayed and the IRS has said that the rules will not be enforced until implementing regulations have been issued and have taken effect, which could take years.)

If, however, the employer allows employees to pay for their health care coverage on a pre-tax basis through a cafeteria plan, as is commonly the case, there are separate non-discrimination rules that apply, and those cafeteria plan non-discrimination rules may ultimately prevent the employer from establishing this type of arrangement.

Changes to IRS Health Care Reporting Forms

Q-7: Has the IRS provided any updated guidance on the new health care coverage reporting requirements (i.e., Forms 1094-B, 1095-B, 1094-C, and 1095-C)?

A-7: Yes. The IRS recently issued the new forms for 2015 that will have to be filed in the first quarter of 2016. The IRS also updated the instructions for these forms and, in the process, clarified how certain coverage situations should be reported and coded. We will be summarizing these changes at our Employment Law & Employee Benefits Seminar in early November. In addition, for those who did not have the opportunity to attend our workshops on the new healthcare reporting requirements earlier this year, we will be repeating the workshop in early December with all the latest updates and guidance. Stay tuned for details.

The questions (and especially the answers) in this Alert are necessarily abbreviated due to space limitations and a desire to avoid readers dozing off while reading them. As you can see, though, the legal issues raised in these questions are extremely complex, and the penalties for missteps can be severe. If you have any questions regarding health care reform compliance for employers, please feel free to call Eric Namee, Steven Smith, or Brad Schlozman at (316) 267-2000.

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