

FEBRUARY 2, 2017

**CONGRESS ALLOWS SMALL EMPLOYERS TO PAY  
FOR INDIVIDUAL POLICIES OF INSURANCE**

One of the lesser known, but critically significant, changes ushered in by the Affordable Care Act (“ACA”) was a general prohibition on employers reimbursing the cost of their employees’ individual health insurance policies. The failure to adhere to this rule triggers substantial excise taxes that can break the back of many employers. But in a sign that Congress occasionally *can* come together to enact positive legislation, the passage of the 21<sup>st</sup> Century Cures Act (the “Act”) in December has brought welcome relief for at least some “small” employers desiring to reimburse employees’ individual health care premiums rather than offering their own group health plans.

Here’s a brief run through:

- **What the Act Does.** The Act allows small employers to pay or reimburse employees for the cost of coverage under an individual policy of health insurance, but only if certain conditions are met.
- **Small Employers.** The Act applies only to employers that are not “applicable large employers” (“ALEs”) under the ACA. Bear in mind that, just like the ACA, the Act provides that employers who are part of a “controlled group” or “affiliated service group,” which, collectively, have at least 50 full-time employees, will be deemed to be “applicable large employer members” (“ALE Members”). So neither ALEs nor ALE Members will be able to avail themselves of the benefits of the Act.
- **Prior Law.** Although reimbursements by an employer for coverage under an individual policy had long been allowed under the Internal Revenue Code – the IRS formally ruled that it was permitted back in 1961 in Revenue Ruling 61-146 – the IRS had also taken the position that such reimbursements were not permitted under the “market reform” provisions of the ACA and that providing such reimbursements would trigger an excise tax of \$100 per day per individual. This position was first expressed in a set of Frequently Asked Questions issued in January 2013 and it was reiterated in two subsequent IRS Notices – Notice 2013-54 and Notice 2015-17.

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- **Impact on Large Employers.** For ALEs and ALE Members, this continues to be the law. So, if you are large enough to be subject to a penalty for not offering coverage to “substantially all” of your “full-time employees” (as defined in the ACA), then you cannot reimburse employees for the cost of coverage under individual policies without also triggering the Code § 4980D excise tax.
- **Conditions That Small Employers Must Meet.** Small employers, on the other hand, are no longer subject to the excise tax if they reimburse their employees for the cost of coverage under individual policies, *provided that the following conditions are met:*
  - The arrangement must be entirely funded by the employer. Salary reduction contributions are not permitted.
  - The amount that is paid or reimbursed by the employer:
    - Must be the same for all employees, subject to variations based on the number of family members who are covered and the cost of coverage “in the relevant health insurance market.”
    - Cannot exceed \$4,950 for employee-only arrangements or \$10,000 for arrangements that cover family members. These dollar limits are subject to annual cost-of-living adjustments.
  - The arrangement must be made available to all “eligible employees.” That means all employees except the following:
    - Employees with less than 90 days of service;
    - Employees who are younger than age 25;
    - Employees who are “part-time” or “seasonal” employees;
    - Employees who are covered by a collective bargaining agreement; and/or
    - Employees who are nonresident aliens with no US source income.
  - The employer cannot “offer a group health plan to any of its employees.”
    - This means that a small employer can offer coverage under a group policy or it can pay for (or reimburse employees for) the cost of coverage under individual policies of insurance, but it cannot do both.

- Unless and until the IRS says otherwise, this also seems to mean that a small employer cannot offer other types of group health plans to its employees, including dental and vision plans and/or health flexible spending accounts.
- Before the employer can make the payment or reimbursement of the individual health insurance premium, the employee must provide “proof of coverage.”
- A notice must be provided to each eligible employee:
  - The content of the notice is specified in the Act.
  - The notice must be provided at least 90 days before the beginning of each year, except that newly eligible employees may receive the notice on “the date on which such employee is first so eligible.”
  - A failure to provide the notice exposes the employer to a penalty tax in the amount of \$50 per employee “per incident of failure,” capped at \$2,500 per year. However, a transition rule applies “if such notice is” provided “not later than 90 days after the date of the enactment of this Act.”
- Reimbursements will not be includible in an employee’s taxable income, but must nonetheless be reported on an employee’s Form W-2.

Because the Act was enacted so late in the year, it may be difficult for small employers to take advantage of it during 2017, particularly if they are already offering coverage under a group policy issued in the small group market. However, we would not be surprised if many small employers, particularly the ones with only a small number of employees, choose to take advantage of it in 2018 and future years.

So, for big employers, there’s not much to look at. But for small employers, this could be a game changer. That is, until Congress rewrites the rules again.

If you need further clarification or have any questions regarding the information contained in this Alert, please feel free to call Eric Namee, Steven Smith, or Brad Schlozman at (316) 267-2000.

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