Patterson Belknap Webb & Tyler LLP

Employee Benefits & Executive Compensation Alert April 2015

Limited Relief for Certain Employer Health Plan Premium Payments or Reimbursements

Background

Under so-called "employer payment plans" ("EPPs"), an employer pays or reimburses an employee for substantiated premium costs under individual health plan insurance coverage (*i.e.*, nonemployer individual health plan coverage). Well-settled Internal Revenue Service ("IRS") guidance provides that such payments or reimbursements are not taxable to the employee.

However, such EPPs are treated as group health plans ("GHPs") that, based on their usual design, will fail to comply with certain market reforms that apply to GHPs under the Affordable Care Act ("ACA"). In guidance issued collectively by the IRS, Department of Labor, and Department of Health and Human Services (collectively, the "Agencies"), in the form of November 2014 Frequently Asked Questions ("FAQs") and a September 2013 IRS Notice (Notice 2013-54), the Agencies clarified that an EPP will normally violate the ACA market reforms, without regard to whether the employer treats the payment or reimbursement amount as taxable or nontaxable to the employee. Because such EPPs cannot be "integrated" with individual market health insurance coverage, these EPPs will likely violate the ACA which could result in the imposition of significant excise tax penalties on the employer.[1]

"Retiree-Only" Plan Exception

Under the Internal Revenue Code, the ACA market reforms do not apply to a group health plan that has fewer than two participants who are current employees on the first day of the applicable year. Such arrangements are often referred to as "retiree-only" plans based on the significant limitation on the participation of current employees in such plans. Thus, an EPP that covers no more than one participant that is a current employee of the employer, whether or not the plan also covers one or more former employees, should be able to offer premium payments or reimbursements for individual health insurance coverage, on a pre-tax basis, without violating the ACA market reforms. However, to the extent possible, it is advisable to treat such arrangements as separate from other employee health insurance coverages in order to support the exception for such "retiree-only" plans from the ACA market reforms.[2]

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1 In the case of a failure of an EPP to satisfy the ACA market reforms, the employer (or plan, in the case of a multiemployer EPP) will be subject to an excise tax equal to $100 for each day during the period in which the failure occurs with respect to each individual to whom the failure relates. The tax for any taxable year is limited generally to the lesser of (i) 10% of the aggregate amount paid or incurred by the employer during the preceding taxable year for GHPs or (ii) $500,000. If the failure to meet the ACA market reforms is due to reasonable cause and not to willful neglect, or otherwise was not known, and exercising reasonable diligence would not have been known, to the employer, the excise tax may be waived by the IRS or, in some cases, will not apply.

2 The recently issued IRS Notice 2015-17 (discussed in this Alert) provides that a premium reimbursement arrangement covering only a single employee (whether or not that employee is a "2-percent shareholder-employee" of an S corporation) generally is not subject to the ACA market reforms regardless of whether such a reimbursement arrangement otherwise constitutes a group health plan. The Notice further provides that if an S corporation maintains more than one such arrangement for different employees, then all such arrangements are treated as a single arrangement covering more than one current employee, and thus the "retiree-only" plan exception from the ACA market reforms will not apply. Accordingly, the exception from the ACA market reforms for EPPs intended to constitute "retiree-only" EPPs should apply if all such plans of an employer, in the aggregate, cover no more than one current employee.

New Guidance Offers Limited Transition Relief and Additional Clarification

The positions expressed by the Agencies in IRS Notice 2013-54 and the 2014 FAQs resulted in significant comments and requests for further clarification from the employee benefits community. Accordingly, the Agencies have recently responded with additional guidance in the form of IRS Notice 2015-17 (the "Notice"). This new guidance further clarifies the ACA compliance issues for EPPs and offers special transition relief for EPPs maintained by small employers.

Transition Relief for Small Employers

Under the transition relief, the IRS will not assert an excise tax penalty for 2014 and for the period January 1, 2015 through June 30, 2015 due to the failure of an EPP to satisfy the ACA market reforms if the employer (determined on a controlled group and affiliated service group basis) is **NOT** an "applicable large employer" ("ALE") for the applicable transition relief period. For these purposes, an ALE is an employer that, for a calendar year, employed an average of at least 50 full-time (including full-time equivalent) employees on business days in the preceding calendar year. The employer's ALE status for 2014 will apply in implementing the transition relief for 2014 and the ALE status for 2015 will apply in implementing the transition relief for the January through June 2015 period. For purposes of determining ALE status, an employer may determine such status by reference to a period of at least six consecutive calendar months during 2013 (in determining ALE status for 2014) and 2014 (in determining ALE status for 2015), rather than using the entire calendar year normally applied for such determinations. This special transition relief does not cover "stand-alone" health reimbursement arrangements ("HRAs") (*i.e.*, HRAs that are not integrated with other employer-sponsored GHP coverage) or other arrangements that provide reimbursement to employees for medical expenses other than health insurance premiums. Further, no special transition relief applies to employers that are not "small employers," as described above (*i.e.*, employers that are "applicable large employers" are afforded no transition relief from the ACA market reforms for their EPPs).

Increased Compensation to Assist in Obtaining Individual Health Coverage

The Notice also confirms that if an employer (both "small employers" eligible for the limited transition relief and ALEs not eligible for the transition relief) provides additional taxable compensation to an employee, but does not condition that compensation payment on the purchase of health coverage or otherwise endorse a particular policy, form or health insurance issuer, such compensation arrangement does not constitute a GHP. Thus, the arrangement will not be subject to the ACA market reforms. The Notice indicates that an employer's provision of information to employees concerning the public health exchanges (or "Health Insurance Marketplace") or the premium tax credit (*i.e.*, health exchange premium cost subsidies) would not be considered an endorsement of a particular policy, form or health insurance issuer.[3]

Conclusion

The Notice's provision of temporary transition relief for small employer EPPs and confirmation of an employer's ability

3 The Notice also provides for: (i) confirmation of the nontaxable treatment of payments or reimbursements under an EPP (though such arrangements for employees will likely result in a violation of the ACA market reforms), (ii) relief from the ACA market reforms for certain EPPs that pay or reimburse for Medicare Part B or D premiums, or pay or reimburse medical expenses of employees covered by TRICARE (*i.e.*, medical coverage for military personnel and their families), and (iii) transition relief from the ACA market reforms through 2015 for S corporations with EPPs that benefit a "2-percent shareholder" (*i.e.*, a person that owns, directly or constructively, more than 2% of the outstanding stock or voting stock of the S corporation).

to provide, without conditions or restrictions imposed, additional compensation to assist employees in obtaining health coverage without violating the ACA market reforms is certainly welcome news for employers. However, employers should be mindful of the restrictive eligibility (*i.e.*, employers with fewer than 50 full-time (including full-time equivalent) employees in the preceding calendar year) and limited duration (*i.e.*, January 1, 2014 through June 30, 2015) of the transition relief for small employer EPPs. Thus, timely action will be needed by employers who maintain EPPs and who qualify for the transition relief in order to avoid maintaining EPPs that violate the ACA market reforms (and incurring related excise tax penalties) once the transition relief period ends. Further, employers should remember that those entities that are ALEs are subject to the employer "play or pay" mandate requirements.[4] Thus, the provision of additional taxable compensation to employees to help them obtain individual health coverage through the public health exchanges may, in certain cases (*e.g.*, where the employer does not also offer an "affordable/minimum value" group health plan to its full-time employees), expose employers, which are ALEs, to employer "play or pay" tax penalties.

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4 The rules governing the employer "play or pay" mandate are beyond the scope of this Alert. For a discussion of such employer mandate, see our earlier **Alert**.

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