

Insurance Reimbursements

Many small companies do not have a group health insurance policy, but instead **reimburse employees for their individual health insurance policies, or perhaps pay the premium on the individual policy on behalf of the employee.** If your company follows this practice, please read this email carefully.

We first notified our clients last December that the IRS and the Department of Labor (DOL) had just issued a notice saying the practice of reimbursing or paying individual insurance policies violated the provisions of the Affordable Care Act (ACA). The prohibition applied if the employer reimburses two or more employees. At the time, the notice was vague and most CPA's generally believed (or hoped) that as long as the reimbursement was added to the employee's taxable salary, the payment of the health insurance premiums would not violate ACA.

On November 6, the Department of Labor (DOL) issued further clarification of the notice that had been issued a year previously. We were hoping for some relief to this harsh provision, but to our surprise, the DOL said this:

"If the employer uses an arrangement that provides cash reimbursement for the purchase of an individual market policy, the employer's payment arrangement is part of a plan, fund, or other arrangement established or maintained for the purpose of providing medical care to employees, without regard to whether the employer treats the money as pre-tax or post-tax to the employee. Therefore, the arrangement ... will violate PHS Act sections 2711 and 2713, among other provisions, which can trigger penalties such as excise taxes under section 4980D of the Code."

The penalty for violating the provision is incredibly harsh, \$100/day/employee. We have not heard of instances of the IRS or DOL actually enforcing the penalty. Nevertheless, it is their position that they have the authority to enforce the penalty.

As a result, we are advising our clients to cease reimbursement or payment of individual health insurance policies. In lieu you may wish to increase employee's salaries and allow them to pay their own insurance policies. I will refer to this salary increase as "supplemental compensation". The guidance is not clear whether you are able to identify this supplemental payment as a "health insurance allowance" or not. My argument is that an allowance is not the same thing as a reimbursement and therefore should not fall under the prohibition. Nevertheless, it would be prudent not to identify this "supplemental compensation" as anything associated with health insurance. You should just add it to regular wages. If you do want to identify the amount separately, you should call it "supplemental compensation". It should be part of regular salary and not as a separate check. Additional points regarding this arrangement:

- The employee will now be taxed on this supplemental compensation.
- The employer and employee will have to pay FICA tax on the supplemental compensation.
- The employee will be able to deduct the cost of the health insurance premium as a medical expense on his or her individual tax return.
- Remember, NONE of this applies if you only reimburse the individual policy of one employee.

If you have continued this practice in 2014, our advice is to add the reimbursement to the employee's W-2 in 2014, and change your practice to the procedures described above beginning in 2015. If additional guidance is released on this topic, we will let you know. We are certainly keeping our fingers crossed for some relief from these provisions.

Please contact our office should you have questions on this topic.

Our wishes to each of you for a Happy and Prosperous New Year.

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