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Update on Pre-Taxing Individual Coverage

Update to Notice 2013-54 Blog Post:

One of the questions that we commonly receive is that the Notice does not mention cafeteria plans or 125, so why doesn't a PRA under a cafeteria plan still work? Prior to the Notice, many employers used a premium reimbursement account (PRA) under 125 where the employer made a pre-tax contribution and employees potentially also made pre-tax contributions, and then used those pre-tax funds to purchase individual coverage. The reason why this type of arrangement no longer works under the Notice, is that such an arrangement is included in the definition of an "employer payment plan" under the Notice. An employer payment plan is any plan that relies on the exclusion from income under Code Section 106. At the same time, Code Section 125 merely provides for the non-taxability of the choice between cash and pre-tax benefits. Code Section 125 does not provide the actual exclusion from income for employer-provided health coverage, that exclusion is reserved exclusively for Code Section 106. Therefore, any contributions to a PRA by an employer (or an employee under 125, because such employee contributions are treated as employer contributions for tax purposes), will be treated as an employer payment plan. Employer payment plans for individual coverage then fail under Q&A-1 of the Notice. The only exception to this is for small employers (under 50 employees) who have obtained SHOP coverage through the public exchange and can qualify under Code Section 125(f)(3)(B). At the same time, a PRA that is treated as taxable to the employee is excepted from the definition of employer payment plan as well.