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Pre-Tax Individual Medical Coverage Dealt a Significant Blow

On Friday last week, Treasury, DOL and HHS issued new guidance with respect to employers who sought to drop group coverage in exchange for individual policies. The guidance issued as IRS Notice 2013-54 and DOL Technical Release 2013-03 discussed the use of health reimbursement arrangements, premium reimbursement arrangements and other employer payment plans to pay for individual policy premiums. Since the passage of the Affordable Care Act, and the rise of the employer mandate in 2014 (now 2015), some employers were looking toward dropping group coverage and then providing their employees with cash to offset the cost of individual policy premiums. In some cases, those individual policies would be purchased on a public exchange, but in other cases they could be purchased on a private exchange or in the individual market. The guidance now makes clear that an employer can still do that, but only if the cash provided to employees is after-tax. In other words, the amount provided in the premium reimbursement arrangement must be treated as taxable wages.

This sets up a clear demarcation line between group and individual coverage for employers. The choice for employers is now between two stark differences –

1. Provide group medical coverage to employees on a tax-free basis. Employees can pay their share of the coverage costs on a pre-tax basis. Assuming the medical coverage meets minimum value and is affordable, the employer penalty will not apply.
2. Provide no medical coverage to employees. Give employees extra taxable wages to pay for their own individual policy coverage. Employer pays the employer penalty.

In other words, if you want to stay in the game, you need to be on the field, and not on the sidelines.

The above guidance only applies to employee coverage. If an employer has a true “retiree-only plan” under the Code and ERISA, then an employer can still sponsor an HRA or PRA and reimburse individual policy premiums on a pre-tax basis.