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Reimbursement of Individual Medical Policy Premiums Prohibited

When an employer reimburses an employee or former employee for the cost of an individual medical policy, whether on a pre-tax or after-tax basis (or directly pays for these individual policy premiums), it creates an "employer payment plan" under recent IRS guidance. Reimbursement of individual policy premiums is typically done by small employers who choose not to establish a group medical plan, but it may arise in employment or severance agreements as well. Through various notices and FAQs, the IRS has made it abundantly clear that employer payment plans are subject to the Affordable Care Act but will fail to comply with many of its requirements – resulting in an excise tax of $100 per day, per applicable employee under Code Section 4980D. As a result, these practices must be restructured.

Keep in mind that this prohibition applies to the reimbursement of individual medical policy premiums – not the reimbursement of COBRA premiums. It also does not apply to an employer that provides an employee or former employee with additional taxable cash compensation that can be used by the individual for any purpose, provided the additional compensation is not conditioned on the individual obtaining individual medical insurance. For example, if you increase an employee's taxable cash compensation by $3,000 with the idea that the employee can use this money to pay for individual medical policy premiums, this practice is acceptable under the new rules, as long as there is no requirement on the employee to actually use the funds for such purpose.

IRS Notice 2015-17 does provide some transitional relief from the application of the excise tax through June 30, 2015, for certain small employers. To be eligible for this relief, an employer cannot be an Applicable Large Employer under the Affordable Care Act (in general, cannot have employed 50 or more full-time equivalent employees during the prior calendar year). The Notice also provides some guidance to S corporations. An explanation of the transition relief is beyond the scope of this summary, so if your company maintains an employer payment plan, it will be important to review the IRS Notice. Additional helpful information can be found here.