# GOVERNMENT MOVES TO PREVENT HEALTH POLICY REIMBURSEMENTS

US employers trying to contain health care costs just got more bad news. On November 6, 2014, in answers to "frequently asked questions," the US Department of Labor ("DOL") killed cost savings strategies that were especially helpful to small and mid-size businesses. Employers may not reimburse employees for the cost of individual health policies, even with after-tax dollars. The DOL opinion extends to all employers, including those which are too small - less than 50 full-time equivalents - for the "pay or play" penalties of the Affordable Care Act ("ACA").

## *Legal Background*

In September, 2013, the DOL and health care regulators took the position that reimbursement for individual policy purchases was not permitted. They pointed to the Internal Revenue Code, which denies pre-tax treatment under a Section 125 plan for policies bought through an ACA Exchange, and then went further. Under ACA, health plans are not supposed to have annual limits. The regulators opined that helping a person to buy an individual policy was the same thing as sponsoring an illegal employer plan with annual limits, because the employer reimbursements were limited to the annual premium amounts. Although the government logic was debatable, many employers stopped the practice, rather than risk ACA penalties. Some advisors, however, pointed to language in the 2013 ruling which did not explicitly outlaw after-tax reimbursements. The November 6 DOL release was meant to stop that.

## *Prohibited strategies*

- An employer offers to reimburse employees for some or all of their premium costs to buy individual health insurance policies providing major medical coverage. Not allowed, whether the reimbursement is pre-tax or after-tax.

- An employer limits an after-tax reimbursement program to employees who are high-risk or have high-risk dependents, and even offers them a bonus above the premium cost. Not allowed. The DOL rejects the argument that this is the type of benign discrimination which it permits for high risk individuals.

- An employer offers an HRA program through a third party vendor, under which employees may select reimbursable policies with outside counsellors and no employer involvement. The DOL rejects the theory that this is a voluntary employee plan, and holds that it is an employer-sponsored plan that violates the ACA prohibition of health plans which have annual limits.

## *Permitted strategy*

Few employers would find this attractive, but a taxable salary increase with no strings attached is allowed. The employee then has the choice to keep the money or spend it for individual insurance. Because there are no strings, an employee could also keep the money and stay in the employer's group plan if one is available.

*Penalties, and solutions for employers that have violated the rules*

For large employers – more than 50 full-time equivalents – none of these strategies would have exempted them from the pay or play penalties that go into effect in 2015. Still, for the "lasered" high risk individual in a self-insured plan, or the high-claims person in an experience-rated insured plan, the pay or play penalties for these persons would usually be less expensive than keeping them covered under group insurance.

The problem is that the DOL guidance adds in a different type of penalty which is assessed on any employer, even the smallest, if it offers a health plan that does not comply with ACA.

> *Welcome to Internal Revenue Code Section 4980D tax penalties, and the self-assessment process of Form 8928.*

The 4980D tax penalty is $100 per day "with respect to each individual to whom such failure relates." If discovered on examination, the minimum penalty is $2,500 and $15,000 if violations are "more than "de minimis." The maximum penalty for "unintentional failures" is 10% of the amount the employer paid for all group health plans in the previous year or $500,000.

The 4980D penalty will not apply if the employer can demonstrate that it could not have known of the violation by exercise of reasonable due diligence. Also, penalties may not apply if the employer can demonstrate that the failure was due to reasonable cause rather than willful neglect and was corrected within 30 days of when it first knew (or should have known with reasonable diligence) that the failure existed.

Dealing with 4980D penalties requires legal judgment calls which are beyond the scope of this brief article. One possible approach, for those who do not want to play "audit lottery," is to discontinue any outlawed policy immediately and to review carefully the instructions to Form 8928 with counsel. In addition, do not forget other penalties which may apply, such as:

- Medicare Secondary violations for the disabled, when employers with at least 100 employees incentivize shift of disabled covered lives to Medicare; and

- Medicare Secondary violations for the elderly, when employers with at

least 20 employees incentivize participants to shift older covered lives to Medicare; and

- Section 105(h) tax assessments when discriminatory arrangements in self-insured plans are made for employees in the top 25% of the payroll.

### *Conclusion*

The problem of insuring high risk individuals predates the ACA. For the largest employers, with thousands of employees, the costs can be spread out. For the smallest, it is possible to buy group policies in small group markets which are not experience-rated. Those in between must shoulder the bad luck of high risk individuals whose treatment can raise costs to unaffordable levels, both for the employers and their employees. Buying individual policies would have helped contain costs for employers paying a fair share.

In addition, there are many employers who can't afford group insurance at all, but who would still like to help some of their employees to buy individual policies. Those employers and their employees are also out of luck.

The ACA Exchanges, with individual policies that did not penalize the hard to insure, offered promise. It is unfortunate that federal regulators stayed with a same-old philosophy that employers can't help unless they buy group coverage.

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