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Acadia BENEFITS INC.

WHAT YOU NEED TO KNOW

IRS Memo on Fixed Indemnity Health Plan Benefits Tax Treatment

On January 20, 2017, the IRS released a Memorandum on the tax treatment of benefits paid by fixed indemnity health plans that addresses two questions:

1. Are payments to an employee under an employer-provided fixed indemnity health plan excludible from the employee's income under Internal Revenue Code §105?
2. Are payments to an employee under an employer-provided fixed indemnity health plan excludible from the employee's income under Internal Revenue Code §105 if the payments are made by salary reduction through a §125 cafeteria plan?

The IRS concluded that an employer may not exclude payments under an employer-provided fixed indemnity health plan from an employee's gross income if the coverage's value was excluded from the employee's gross income and wages. Further, an employer may not exclude payments under an employer-provided fixed indemnity health plan if the plan's premiums were made by salary reduction through a §125 cafeteria plan.

Background

A fixed indemnity health plan pays a specific amount of cash for certain health-related events (for example, $40 per office visit or $100 per hospital day). The amount paid is neither related to the medical expense incurred, nor coordinated with other health coverage. Further, a fixed indemnity health plan is considered an "excepted benefit."

Under HIPAA, fixed dollar indemnity policies are excepted benefits if they are offered as "independent, non-coordinated benefits." Under the Patient Protection and Affordable Care Act (ACA), excepted benefits are not subject to the ACA's health insurance requirements or prohibitions (for example, annual and lifetime dollar limits, out-of-pocket limits, requiring individual and small-group policies to cover ten essential health benefits, etc.) This means that excepted benefit policies can exclude preexisting conditions, can have dollar limits, and do not legally have to guarantee renewal when the coverage is cancelled.

Further, under the ACA, excepted benefits are not minimum essential coverage so a large employer cannot comply with its employer shared responsibility obligations by offering only fixed indemnity coverage to its full-time employees.

Some examples of fixed indemnity health plans are AFLAC or similar coverage, or cancer insurance policies.

Analysis

Generally, the Internal Revenue Code imposes taxes on wages paid with respect to employment. For federal income tax withholding, the Internal Revenue Code generally requires every employer who pays wages to deduct and withhold taxes on those wages.

In the context of an employer-provided fixed indemnity health plan, when the employer's payment for coverage by the fixed indemnity plan is excluded from the employee's gross income, then the payments by the plan are not excluded from the employee's gross income.

In contrast, when the premiums are paid with after-tax dollars, the payments by the plan are excluded from the employee's gross income.

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