

IRS EXPRESSES VIEW ON THE TAX TREATMENT OF CASH PAYMENTS UNDER EMPLOYER-SPONSORED FIXED INDEMNITY WELLNESS PLANS

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Last month, in a Memorandum dated December 12, 2016, the Office of Chief Counsel of the Internal Revenue Service issued important guidance regarding the taxation of benefits (including wellness benefits) that are paid under employer-sponsored “fixed indemnity” health plans that qualify as accident and health plans under section 106 of the Internal Revenue Code. In the Memorandum, the IRS concludes that benefits paid under such plan are taxable when the premiums are paid with before-tax employer contributions, or before-tax employee contributions through a cafeteria plan. The Memorandum can be found [here](#).

The guidance includes examples similar to the following:

Example 1

Facts. An employer provides all employees, regardless of enrollment in other comprehensive health coverage, with the ability to enroll in coverage under a fixed indemnity health plan. Premiums for the coverage are paid with after-tax contributions (i.e., the amount of the premium is included in employees’ gross income and wages for federal tax purposes). Under the policy, employees receive \$100 for each medical office visit, and \$200 for each day in the hospital, without regard to the amount of medical expenses otherwise incurred by the employee.

Conclusion. In this situation, the IRS concludes that because the premiums for the fixed indemnity health plan are included in the employee’s gross income and wages (i.e., the employee is taxed on the value of the coverage), the benefits received are excluded from the employee’s gross income and wages.

Example 2

Facts. The same facts as Example 1, **except** that the employer provides the coverage to the employees at no cost to the employee.

Conclusion. In this example, the IRS concludes that because the premiums for the fixed indemnity health plan are paid with amounts that **are not** included in the employee’s gross income and wages, the **benefits** are included in the employee’s gross

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income and wages, regardless of the amount of any medical expenses incurred by the employee upon which the payment is conditioned.

Example 3

Facts. The same facts as Example 1, **except** that the employees electing to participate in the fixed indemnity health plan pay premiums on a before-tax basis by salary reduction through a § 125 cafeteria plan; therefore, the amount of the salary reduction is not included in compensation income at the time the salary would otherwise have been paid.

Conclusion. The IRS's conclusion is the same as in Example 2 because the premiums for the fixed indemnity health insurance are paid with amounts that are not included in the employee's gross income and wages.

Example 4

Facts. An employer provides all employees, regardless of enrollment in other comprehensive health coverage, with the ability to enroll in coverage under a "wellness plan." Employees electing to participate in the wellness plan pay for the coverage with before-tax contributions through the employer's § 125 cafeteria plan; therefore the amount of the salary reduction is not included in compensation income at the time the salary would otherwise have been paid. Under the wellness plan, employees receive \$100 for completing a health risk assessment, \$100 for participating in certain prescribed health screenings, and \$100 for participating in other prescribed preventive care activities, without regard to the amount of medical expenses otherwise incurred by the employee.

Conclusion. In this example, the IRS concludes that because the employee contributions are paid with amounts that are not included in the employee's gross income and wages, the wellness payments are included in the employee's gross income and wages, regardless of the amount of any medical expenses incurred by the employee upon which the payment is conditioned.

Example 5

Facts. The same facts as Example 4, except that the wellness plan pays employees a fixed indemnity cash payment benefit each pay period (for example, equal to a percentage of the salary payable for the pay period) for participating in the wellness plan, without regard to the amount of medical expenses otherwise incurred.

Conclusion. Same as Example 4.

The IRS guidance is a much needed response to the seeming proliferation of fixed indemnity and wellness program designs, like the designs in Examples 2 – 5, that purport to qualify as "medical care" which, as a general rule, is provided to employees and their dependents on a tax-free basis as to both the value of the coverage (i.e., employer-paid premiums) and receipt of benefits. In this Memorandum, the IRS makes it clear that fixed indemnity coverage is more akin to "income replacement" insurance (e.g., disability insurance) than medical insurance. Like disability insurance benefits, the cash payments that are received under the plans in Examples 2-5 *are not tied to or coordinated with the cost of medical care*, and can be spent in any way the employee chooses. If an employer sponsors a fixed indemnity plan that operates like one of the arrangements in Examples 2-5, and does not include the benefits received in the employee's wages, the employer should engage the promoter of the arrangement, its broker or consultant, or its counsel in a dialogue to determine next steps.