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Office Memorandum

To: Adam Ripple
From: Kaylin Ness
Re: City of Rockville Healthcare Insurance Question
Our File: 16642-0004
Date: April 25, 2016

Background

Currently the City of Rockville (the “City”) offers its employees the option to obtain their health insurance coverage through Blue Cross and Blue Shield of Minnesota with the City paying 80% of the cost and the employee paying the remaining 20%. The City offers this benefit to its four full time employees, and two currently take it. In the event that an employee opts out of the healthcare coverage the City then reimburses the employee an amount equal to the exact 20% premium the individual would have paid for the health insurance. Currently, two employees have chosen to take the reimbursement in lieu of the health insurance benefit. One receives the reimbursement in cash (after taxes) and one puts the money in a qualified retirement plan. The City classifies this reimbursement as “Payment in lieu of health” on its payroll documentation. The questions presented is whether the City’s current process is subject to penalties under the Affordable Care Act as a result of cash benefits given to employees who opt out of the employer sponsored healthcare plan?

Short Answer

If the City of Rockville is providing a group health plan, then yes it could possibly be subject to penalties under the Affordable Care (the “ACA”).

Analysis

If an employer provides a health insurance plan that constitutes an employer payment plan as defined by Revenue Ruling 61-146, C.B. 1961-2, 25, the plan is considered a group health plan under the ACA. As a result the plan will be subject to certain ACA market reforms. If the plan does not comply with market reforms, the employer will be subject to a penalty of \$100 per day per affected individual until corrected (§4980D excise tax). On the other hand, if the plan does not constitute an employer payment plan then it is not subject to and will not have to comply with such market reforms.

I. Does the City Cash Reimbursement to the Employees violate ACA market reforms?

First, it is important to note that the City is not subject to the Affordable Care Act (ACA) mandate to provide healthcare insurance to its employees because it has less than 50 full-time equivalent employees. But, since the City of Rockville does offer employer sponsored health care insurance there are a few ACA provisions the City is subject to, and it is possible the City's current practice is violating the ACA market reforms.

An employer payment plan, according to IRS Notice 2013-54, refers to a group health plan under which an employer reimburses an employee for some or all of the premium expenses incurred for an individual health insurance policy or directly pays a premium for an individual health insurance policy covering the employee, (such arrangements are described in Revenue Ruling 61-146, 1961-2 C.B. 25).

Under Revenue Ruling 61-146, an employer payment plan exists in the case where employees are not covered by an employer's group policy but rather have other types of hospital and medical insurance for which they pay the premiums directly to the insurers, and the employer pays a part of such premiums using one of the following methods:

(1) reimburses each employee directly once or twice a year for the employer's share of the insurance premiums upon proof of prior payment of the premiums by the employee;

(2) issues to each employee a check payable to the particular employee's insurance company, the employee being obligated to turn over the check to the insurance company; or

(3) issues a check as in method (2) except the check is made payable jointly to the insurance company and the employee.

Prior to the implementation of the ACA, an employer could reimburse or directly pay for an employee's individual health insurance and exclude such payment from the employee's income pursuant to IRS Code §106. Conversely, after the enactment of the ACA if an employer provides an employer payment plan, the plan is subject to ACA market reforms including the prohibition on annual limits for essential health benefits and the requirement to provide certain preventative care without cost sharing. As a result, an employer payment plan violates the benefit mandates for group health coverage due to the fact the premium amounts reimbursed constitute an annual limit and will inherently cause cost sharing for the required preventative care benefits, causing the employer to be subject to the assessment of the §4980D excise tax of \$100 per day per affected individual until corrected. This excise tax is applicable to all employers, regardless of their size.

Even though the IRS provided transition relief from the assessment of excise tax if the employer healthcare arrangement that constituted (1) employer payment plans, as described in Notice 2013-54, if the plan is sponsored by an employer that is not an Applicable Large Employer (an employer that employed an average of at least 50 full-time employees in the year prior), this relief ended June 30, 2015. Meaning, if the City reimburses its employees using one of the methods under Revenue Ruling 61-146, it could be subject to the §4980D excise tax in connection with the employees receiving the cash benefit in lieu of the health insurance because it constitutes an employer payment plan and therefore violates the ACA market reforms.

II. How to Structure the City's Employee Cash Reimbursement.

IRS Notice 2015-17 is instructive on how arrange such a cash reimbursement structure plan so it may operate without violating the ACA. Pursuant to IRS Notice 2015-17, if an employer increases an employee's compensation, but does not condition the payment of the additional compensation on the purchase of health coverage (or otherwise endorse a particular policy, form, or issuer of health insurance), it will not be considered an employer payment plan. If these "reimbursements" are just put in the employees check as a bonus, and they may or may not be used to be paid for individual healthcare plans, they will not constitute an employer payment plan subject to the market reforms.

In addition, the City taxing the money given to the employees who opted out of the employer healthcare plan, as income, compared to a typical Section 105 reimbursement (amounts expended for medical care) which are excluded from an employee's income, is another supportive fact pointing towards this reimbursement not being subject to group health plan requirements under the ACA.

Conclusion/Recommendations

It is possible the City's current reimbursement practice for the two employees not receiving healthcare benefits could be considered an employer payment plan and in turn a group health plan subject to and violating ACA market reform requirements. However, it is important to note that since the ACA is such a new law, and the excise tax provision that would affect the City only has been implemented for under a year, and there is no instructive case law on the subject, it is tough to come a conclusion with complete certainty.

The City has a few options going forward. The most conservative option is an all or nothing structure. This structure could be executed in two ways:

1. Still offer health insurance benefits, but if an employee elects not to take them, they do not receive a reimbursement in lieu of health insurance benefits.
2. Not offer health insurance benefits whatsoever and increase the employees' salaries instead.

The least conservative (grey area) option is a split structure. Much like the City's current practice, the City continues to offer the health insurance benefits to its employees, and for those employees who elect not to take them, structure the reimbursement in lieu as a cash bonus in order to distinguish it from ordinary pay, and ensure the reimbursement is not conditioned on the employee using it to purchase health insurance. The City should set one reimbursement amount for all employees rather than having it reflect the exact amount the health insurance premium would have been if the employee did elect to take the benefits because if the City treats employees differently by differentiating the amount of the cash bonus based upon a protected class (marital status, familial status, etc.) the City could be exposed to a possible discrimination claim. Additionally, the City should re-classify the reimbursement on its payroll documentation. How this would look would have to be further discussed.

Another aspect of this situation to be cognizant about is the health insurance the employees do obtain outside of the BCBS plan offered by the City. When an employer offers qualifying coverage (it meets the affordability and minimum-value guidelines), and an employee elects to opt out of the plan, he/she cannot then purchase health insurance funded by marketplace

subsidies. Since City employees are offered qualifying coverage (the BCBS plan), the City's employees should not purchase marketplace subsidy plans if the employee opts out of the City's employer offered plan.