HCR
ALERT

June 3, 2016

Beware of FICA-Reduction Arrangements Using Wellness Programs

It has come to our attention that certain arrangements are being marketed to employers that are intended to reduce an employer's FICA obligation by significantly increasing employees' pre-tax salary reductions. We want to caution employers against entering into these types of arrangements before having a conversation with an employee benefits attorney who understands them. This alert provides some background on these schemes and our concerns with them.

Background

Over the last 15 years, we have seen certain arrangements that reappear from time to time. They come with various bells and whistles but they all have a common feature: they purport to have found a new way to save employers money on their FICA contributions at no cost to the employer or employees. Promotional materials from the vendor show employees receiving the same take home pay they received prior to the employer adopting the program, with perhaps even a little extra to spend on voluntary products.

The earliest versions were known as "double-dip" arrangements, where employees were reimbursed for premiums that had already been paid on a pre-tax basis. Once those were prohibited (Rev. Rul. 2002-3), variations surfaced. Under one, employees were reimbursed in advance for potential future medical expenses. Under another, employees received "loans" that were either offset by unreimbursed medical expenses or forgiven. In response, the IRS issued guidance (Rev. Rul. 2002-80) prohibiting those two variations. A more recent twist on the loan program involves the use of credit life insurance to secure the loan rather than it being forgiven, although it would also appear to be prohibited under Rev. Rul. 2002-80, as it is understood that the employee will never become obligated to repay any of the purported "loan." A loan that is forgiven or never intended to be repaid results in taxable income.

These arrangements were all variations on a theme:

- They're marketed as being no cost to the employer;
- They're marketed as being no cost to employees;
- The vendor is paid with part of the savings (more on this later);
- The vendor indicates it's only recently become available due to changes in the law,

which is why your attorney or broker hasn't heard of it yet;

- The vendor has a legal opinion but won't share it unless you sign a confidentiality agreement; and
- They accomplish something by using multiple steps that you're pretty sure would be illegal if done directly.

We have described these arrangements in case there are any similarities to one you may have been pitched recently.

The Wellness Approach

The latest iteration of these schemes involves a wellness program. From what we can gather, the proposed process works something like this:

- Employees make a significant pre-tax contribution (around half of their gross wages) into a self-insured group health plan that is basically a wellness program.
- The wellness program requires employees to engage in some activities, such as completing a health questionnaire, taking a phone call from a nurse or watching a video on a health-related topic, in order to qualify for a "reward".
- The "reward" is coverage under a health reimbursement program (HRP) which is also a self-insured group health plan.
- Employees can use funds in the HRP to reimburse themselves on a non-taxable basis for their premiums paid to the wellness program.
  - **This is the crux of the arrangement right here. This is how employees get all of their pre-tax money back.**
  - **However, if the reimbursements from the HRP are not excludable from employees' income, then the employer and employees are back at square one.**

As discussed below, an employee's reimbursement from the HRP is not excludable from income if it is reimbursing contributions the employee made to the wellness program on a pre-tax basis.

We understand that the IRS released guidance a few years ago (Notice 2013-54) that described how a health reimbursement arrangement (HRA) could be integrated with the group health plan of a spouse's employer and be used to reimburse premiums paid under the spouse's plan. However, in October 2015, the IRS's Office of Chief Counsel released memorandum Number 201547006, which clarifies that an HRA (or HRP, for that matter) can only reimburse group health plan premiums that were paid on an after-tax basis and not through salary reduction under a Section 125 plan. In addition, the Office of Chief Counsel recently commented informally on this type of wellness arrangement saying that amounts reimbursed to employees are taxable, notwithstanding what promoters claim.

In other words, the HRP's reimbursement of wellness plan premiums is illegal. An employer using one of these arrangements will be exposed to under-reporting and under-withholding penalties (as well as back taxes), because they've failed to include the HRP reimbursement in income when it's used to reimburse the wellness plan premium. There is also the concept of "secondary liability," under which the employer becomes liable for the employees' portion of FICA taxes, which cannot be collected from the employees.

What's Really Going On

Of course, these schemes present a number of issues. We're just pointing out one. There are others. For example, the final Americans with Disabilities Act (ADA) regulations that were released May 16 restrict rewards under all wellness programs (including participatory programs) to 30% of the cost of self-only coverage. The Equal Employment Opportunity Commission would consider these arrangements to be a *per se* violation of the ADA because the reward exceeds 30% of the cost of coverage.

Even if these programs worked, the savings is 7.65% on amounts employees contribute pre-tax, which is the employer's share of FICA. The promoter is typically looking for 5% of FICA as part of its administrative fee, which is 65% of the employer's savings!

Also, it is important to remember that these arrangements are not fair to employees, as they often do not understand the potential consequences. Significantly reducing income via pre-tax salary reductions may decrease an employee's social security retirement income, particularly for lower paid employees.

As mentioned, any employer considering one of these arrangements should consult with an employee benefits attorney with whom they have a direct attorney-client relationship.

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Your Trion Strategic Account Managers are here to answer any questions you might have as you prepare to comply with upcoming ACA requirements. If you are not currently a Trion client and would like assistance navigating the changes required by health care reform, please contact us today by emailing trionsales@trion-mma.com.

ACA Guidance Released in the Last Two Months

May 2016:	EEOC Issues Final ADA and GINA Rules on Wellness Programs and ADA FAQs ar
May 2016:	ACA FAQs 31 – Patient Bill of Rights Topics
Apr. 2016:	IRS Issues Rev. Proc. 2016-24 2017 Affordability Threshold & Marketplace Require Percentages
Apr. 2016:	Agencies Issue Revised SBC Template, Instructions, Uniform Glossary, and Other Documents

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information. Rather, the content is intended as a general overview of the subject matter covered.

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