Prior to the enactment of the Affordable Care Act ("Obamacare") many employers provided health benefits for their employees by paying health insurers directly for the cost of private health insurance, or by reimbursing employees for the substantiated cost of insurance premiums. The amounts paid by employers under such arrangements were nontaxable fringe benefits under section 106 of the tax code, which states that, with some exceptions, "gross income of an employee does not include employer-provided coverage under an accident or health plan."

The IRS affirmed the tax-free status of these arrangements in a 1961 ruling. It concluded that if an employer reimburses an employee's substantiated premiums for non-employer sponsored medical insurance, the payments are excluded from the employee's taxable income under section 106. IRS Revenue Ruling 61-146. The IRS added that this exclusion also applies if the employer pays the premiums directly to the insurance company.

**Example.** A church does not have a group health plan for its employees. Instead, employees purchase their own health insurance through private insurers, and the church reimburses employees who substantiate the amount of the health insurance premium they paid. Prior to the Affordable Care Act, the employer's reimbursement of insurance premiums under such an arrangement was a nontaxable fringe benefit, subject to some conditions.

**Example.** Same facts as the previous example, except that the church paid the insurance companies directly for the cost of health insurance premiums on policies secured by their employees. Prior to the Affordable Care Act, the employer's payment of insurance premiums under such an arrangement was a nontaxable fringe benefit, subject to some conditions.

Are these common and longstanding arrangements affected by the Affordable Care Act? Can employers continue to treat their payment of the health insurance premiums of employees under individual health insurance policies as a nontaxable fringe benefit? If they pay some or all of the premiums of their employees' private health insurance, are its payments a nontaxable fringe benefit as in prior years? And what about churches that drop their health coverage in favor of what they assume will be a lower cost alternative of paying some or all of their employees' premiums for insurance coverage purchased on a state exchange? Is this a nontaxable fringe benefit?

In late 2013, the IRS and Departments of Labor and Health and Human Services addressed these questions directly in IRS Notice 2013-54 ("Notice"). The Notice concludes that two of the Affordable Care Act’s "market reforms" apply to all "group health plans," with a few exceptions, and it defines group health plans to include plans under which "an employer reimburses an employee for some or all of the premium expenses incurred for an individual health insurance policy . . . or arrangements under which the employer uses its funds to directly pay the premium for an individual health insurance policy covering the employee" (collectively, an "employer payment plan").

The Affordable Care Act contains several "reforms" of the insurance market (the "market reforms") that apply to "group health plans" effective January 1, 2014. The market reforms include:

- The "annual dollar limit prohibition." A group health plan may not establish any annual limit on the dollar amount of benefits for any individual.

- The "preventive services requirement." Employer-sponsored group health plans must provide certain preventive services without imposing any cost-sharing requirements for these services on employees.

The Notice concludes that in most cases employer payment plans will fail to meet these market reforms and therefore will be unlawful under the Affordable Care Act because they typically impose limits on benefits in violation of the annual dollar limit prohibition. The Notice explains:

A group health plan, such as an employer payment plan, that reimburses employees for an employee's substantiated individual insurance policy premiums must satisfy the market reforms for group health plans. However the employer payment plan...
will fail to comply with the annual dollar limit prohibition because (1) an employer payment plan is considered to impose an annual limit up to the cost of the individual market coverage purchased through the arrangement, and (2) an employer payment plan cannot be integrated with any individual health insurance policy purchased under the arrangement.

**KEY POINT.** A group health plan that violates one of the market reforms is subject to a penalty in the form of an excise tax of $100 per day per affected individual.

Are there any exceptions to these rules? Is there any way for churches to continue paying for employees' health insurance through private insurers or state exchanges as a nontaxable fringe benefit? The Notice mentions three possibilities:

- The market reforms do not apply to a group health plan that has fewer than two participants who are current employees on the first day of the plan year.
- The market reforms do not apply to a group health plan with regard to "excepted benefits" which are defined to include disability income, dental and vision benefits, long-term care benefits, and certain health FSAs. As a result, these plans are not necessarily prohibited for failing to comply with the Affordable Care Act’s market reforms.
- Another option that may allow some churches to continue to pay employee insurance premiums on a pre-tax basis is to participate in the "SHOP" (Small Business Health Options Program) marketplace. The SHOP marketplace makes it possible for small employers to provide qualified health plans to their employees. Some conditions apply. For 2014, the SHOP marketplace is open to employers with 50 or fewer full-time equivalent employees (FTEs). You may qualify for tax credits if you use SHOP. The small business health care tax credit that many churches received in the past is only available for 2014 for plans purchased through the SHOP marketplace.

**Key point.** The Department of Health and Human Services announced in late 2013 that online enrollment in the federal SHOP marketplace is being delayed a year until November 2014. However, in lieu of online enrollment in the federal SHOP marketplace, HHS is allowing small employers to enroll their employees in coverage through an agent, broker, or insurer that offers a certified SHOP plan and has agreed to conduct enrollment according to HHS standards. This process, called direct enrollment, is similar to how most small employers get insurance today. The HHS announcement further provides: "The agent, broker, or insurer will enroll your employees, and the SHOP marketplace will review your application and determine later whether your business and employees are eligible for SHOP coverage. . . . The reason for you to get the SHOP eligibility determination in 2014 is to allow you to claim the expanded Small Business Health Care Tax Credit at the end of your tax year—as long as you also meet all the other requirements for the tax credit." This change to "direct enrollment" in states with a federally facilitated SHOP Marketplace won’t affect the process for getting SHOP coverage in states running their own SHOP Marketplace.

**Key point.** The Notice acknowledges that "employers may establish payroll practices of forwarding post-tax employee wages to a health insurance issuer at the direction of an employee without establishing a group health plan if the standards of the Department of Labor regulation at 2510.3-1(j) are met."

**Effects on HRAs, FSAs, and HSAs**

Many churches have adopted health reimbursement arrangements (HRAs), health flexible spending accounts (FSAs), or Health Savings Accounts (HSAs). Are these plans affected by the recent IRS Notice? **IRS Notice 2013-54** specifies that the Affordable Care Act’s market reforms apply to certain types of group health plans, including HRAs and health FSAs, in addition to the employer payment plans described above.

**HRAs**

The Notice concludes that "standalone" HRAs are no longer permitted by the Affordable Care Act due to their failure to comply with the market reforms. But there are two exceptions:

- HRAs that are "integrated" with other coverage as part of a group health plan are allowed if the other coverage complies with the annual dollar limit prohibition. In such a case, the fact that benefits under the HRA by itself are limited does not fail to comply with the annual dollar limit prohibition because the combined benefit satisfies the requirements. The requirements for integration are explained in the Notice.
- In the case of a "standalone" HRA that is limited to "retirees," the exemption for plans with less than two employees means that the retiree-only HRA is not subject to the annual dollar limit prohibition.

**FSAs**

A health FSA is not subject to the annual dollar limit market reform, but only if it is offered through a "cafeteria plan" that is subject to the separate annual limitation under section 125 of the tax code. Employees electing coverage under a health FSA typically elect to enter into a salary reduction agreement. For plan years beginning after 2012, the amount of the salary reduction is limited to $2,500 (indexed annually for plan years beginning after 2013). There is no similar limitation on a health FSA that is not part of a section 125 plan, and as a result "a health FSA that is not offered through a section 125 plan is subject to the annual dollar limit prohibition and will fail to comply with the annual dollar limit prohibition."

**IRS Notice 2013-54** states:

The market reforms do not apply to a group health plan in relation to its provision of benefits that are excepted benefits. Health FSAs are group health plans but will be considered to provide only excepted benefits if the employer also makes available group health plan coverage that is not limited to excepted benefits and the health FSA is structured so that the maximum benefit payable to any participant cannot exceed two times the participant’s salary reduction election for the health FSA for the year (or, if greater, cannot exceed $500 plus the amount of the participant's salary reduction election). Therefore, a health FSA
that is considered to provide only excepted benefits is not subject to the market reforms. If an employer provides a health FSA that does not qualify as excepted benefits, the health FSA generally is subject to the market reforms, including the preventive services requirements. Because a health FSA that is not excepted benefits is not integrated with a group health plan, it will fail to meet the preventive services requirements.

HSAs
Health Savings Accounts were created by Congress in 2003 as a way to manage health costs by giving consumers an incentive to lower their medical expenses. This was done by limiting eligibility to persons with high deductible health insurance who would then use the savings in premium dollars to invest in an HSA, with the balance in their HSA being accessible to pay qualified health expenses. Unlike FSAs, any balance in an HSA at year-end is not forfeited. It rolls over to succeeding years. Further, beginning at age 65, persons can use their HSA balance to pay for any expenses, including non-medical expenses. So, an HSA can augment retirement savings.

The Affordable Care Act does not prohibit HSAs, but it does affect them in various ways, including the following:

- The penalty for making HSA distributions that are not used for qualified medical expenses increases from 10 percent to 20 percent for those under the age of 65.
- You can receive tax-free distributions from your HSA to pay, or be reimbursed for, qualified medical expenses you incur after you establish the HSA. Qualified medical expenses are those expenses that would generally qualify for the medical and dental expenses itemized deduction on your federal tax return. Also, non-prescription medicines (other than insulin) are not considered qualified medical expenses for HSA purposes. A medicine or drug will be a qualified medical expense for HSA purposes only if the medicine or drug requires a prescription, is available without a prescription (an over-the-counter medicine or drug), and you get a prescription for it, or is insulin.
- Beginning in 2014, all non-grandfathered health insurance coverage in the individual and small group markets will cover essential health benefits (EHB), which include items and services in 10 statutory benefit categories, such as hospitalization, prescription drugs, and maternity and newborn care, and are equal in scope to a typical employer health plan. In addition to offering EHB, non-grandfathered health insurance plans must provide consumers with "minimum value," meaning that the plan provides a minimum "actuarial value" of 60 percent of mandated expenses. This level of coverage is designated as a "bronze" plan. There are also silver, gold, and platinum plans that cover higher percentages of costs. The problem is that persons eligible for an HSA must be covered under a high deductible health plan (HDHP), and such plans may not cover the minimum 60 percent of healthcare costs since the high deductible generally means that the employee is picking up a larger share of medical expenses.

Conclusions
Churches that offer (1) health reimbursement arrangements (HRAs), including HRAs integrated with a group health plan; (2) group health plans under which an employer reimburses an employee for some or all of the premium expenses incurred for an individual health insurance policy, or arrangements under which the employer uses its funds to directly pay the premium for an individual health insurance policy covering the employee; (3) health flexible spending arrangements (health FSAs); or (4) a Health Savings Account, should have them reviewed by legal counsel or a tax professional to ensure that they either comply with the Affordable Care Act’s market reforms, or qualify for an exception.

FINANCIAL Q&A

WHAT INTERNAL AUDIT GUIDELINES SHOULD WE CONSIDER?

The finance-related activities every church should regularly monitor.

By Vonna Lawe

Q: We have never had a CPA or firm come in to do an audit because of the expense. However, we believe it is in the best interest of the church to do quarterly audits. What are some guidelines we should use?

A: Here is a list of items for a full audit that may be helpful. Your board may want to select a few and do them on a rotating quarterly basis:

1. Review internal controls to make certain they are adequate.
2. Review expense reports of executive employees.
3. Review bank reconciliations.
4. Determine if investment statements agree to the general ledger.

5. Make sure there is support for the amounts recorded with accounts and notes receivable.
6. Review property, plant, and equipment (PP&E) to verify additions and disposals have been recorded and depreciation is accurate. Even if you don't operate on an accrual basis, you should still maintain an inventory of fixed assets for insurance and security purposes.
7. Review Accounts Payable and Accrued Expenses to determine all amounts incurred but not paid have been accrued.
8. Review revenue to make sure the donor system is reconciled to the general ledger.
9. Verify the church's debt statement agrees with the general ledger.
10. Reconcile the church's 941 reports with payroll expenses.
11. Analyze current year to prior year amounts of revenue and expense to see if there are any large or unexplained differences.

Vonna Lawe is a partner and West Region Director with Capin Crouse LLP, a certified public accountant firm specializing in nonprofit organizations, and an Editorial Advisor for Church Finance Today.

To submit a question for consideration in a future Q&A, email CFeditor@ChristianityToday.com.
A LOOK AT SALARIES AND BENEFITS FOR SOLO PASTORS
Polled: 624 full-time pastors

96% received a base salary
38% received salary increases

73% received housing benefits
23% lived in a parsonage

94% received paid vacation
63% received auto reimbursement/allowances

51% had health insurance through the church*
14% had disability insurance through the church*
11% had life insurance through the church*

*only those reporting individual premiums

This information first appeared in the 2014-2015 Compensation Handbook for Church Staff. Based on national survey results, the compensation profiles are classified by part-time, full-time, church size, income budget, and geographical setting. Each position's compensation levels are presented based on personnel characteristics. For the full book, visit ChurchLawAndTaxStore.com.

Tax Calendar
Important Tax Deadlines in June 2014

In addition to the regular semimonthly and monthly withholding requirements, churches should note the following dates for this month. If the regular due date falls on a Saturday, Sunday, or legal holiday, file by the next business day.

June 15
- Ministers (who have not elected voluntary withholding) and self-employed workers must file their second quarterly estimated federal tax payment for 2014 by this date. A similar rule applies in many states to payments of estimated state taxes. Nonminister employees of churches that filed a timely Form 8274 (waiving the church’s obligation to withhold and pay FICA taxes) are treated as self-employed for Social Security purposes, and accordingly are subject to the estimated tax deadlines with respect to their self-employment (Social Security) taxes unless they ask their employing church to withhold an additional amount of income taxes from each paycheck that will be sufficient to cover self-employment taxes (use a new Form W-4 to make this request).
- A church must make quarterly estimated tax payments if it expects an unrelated business income tax liability for the year to be $500 or more. Use IRS Form 990-W to figure your estimated taxes. Quarterly estimated tax payments of one-fourth of the total tax liability are due by April 15, June 15, September 15, and December 15, 2014, for churches on a calendar-year basis. Deposit quarterly tax payments electronically using the EFTPS system.

June 30
Now is a good time to review the 2014 housing or parsonage allowances designated for all ministers on staff. Any changes made to an allowance apply prospectively, never retroactively.