Guidance on the Application of Code § 4980D to Certain Types of Health Coverage Reimbursement Arrangements

Notice 2015-17

I. PURPOSE AND OVERVIEW

This notice reiterates the conclusion in previous guidance addressing employer payment plans, including Notice 2013-54, 2013-40 I.R.B. 287,[1] that employer payment plans are group health plans that will fail to comply with the market reforms that apply to group health plans under the Affordable Care Act (ACA).[2] For this purpose, an employer payment plan as described in 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 as arrangements described in Revenue Ruling 61-146, 1961-2 C.B. 25. This notice also provides transition relief from the assessment of excise tax under Internal Revenue Code (Code) § 4980D for failure to satisfy market reforms in certain circumstances. The transition relief applies to employer healthcare arrangements that constitute (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 (ALE) under Code § 4980H(c)(2) and §§54.4980H-1(a)(4) and -2; (2) S corporation healthcare arrangements for 2-percent shareholder-employees;[3] (3) Medicare premium reimbursement arrangements; and (4) TRICARE-related health reimbursement arrangements (HRAs). This notice also provides additional guidance on the tax treatment of employer payment plans. This notice supplements and clarifies the guidance provided in Notice 2013-54 and other guidance

[1] There have been four prior issuances on the topics addressed in this notice: (1) FAQs About Affordable Care Act Implementation (Part XI), issued on January 24, 2013 by DOL (http://www.dol.gov/ebsa/faqs/faq-aca11.html) and HHS (http://www.cms.gov/CCIIO/Resources/Fact-Sheets-and-FAQs/aca_implementation_faqs11.html); (2) IRS Notice 2013-54 and DOL Technical Release 2013-03, issued on September 13, 2013; (3) IRS FAQ on Employer Healthcare Arrangements (http://www.irs.gov/Affordable-Care-Act/Employer-Health-Care-Arrangements); and (4) FAQs About Affordable Care Act Implementation (Part XXII), issued on November 6, 2014 by DOL (http://www.dol.gov/ebsa/faqs/faq-aca22.html) and HHS (http://www.cms.gov/CCIIO/Resources/Fact-Sheets-and-FAQs/Downloads/FAQs-Part-XXII-FINAL.pdf).

[2] The "Affordable Care Act" or "ACA" refers to the Patient Protection and Affordable Care Act (enacted March 23, 2010, Pub. L. No. 111-148), as amended by the Health Care and Education Reconciliation Act of 2010 (enacted March 30, 2010, Pub. L. No. 111-152), and as further amended by the Department of Defense and Full-Year Continuing Appropriations Act, 2011 (enacted April 15, 2011, Pub. L. No. 112-10), Section 1001 of the ACA added new Public Health Service Act (PHS Act) §§ 2711-2719. Section 1563 of the ACA (as amended by ACA § 10107(b)) added Code § 9815(a) and Employee Retirement Income Security Act (ERISA) § 715(a) to incorporate the provisions of part A of title XXVII of the PHS Act into the Code and ERISA, and to make them applicable to group health plans and health insurance issuers providing health insurance coverage in connection with group health plans. The PHS Act sections incorporated by these references are §§ 2701 through 2728. Accordingly, these referenced PHS Act sections (i.e., the market reforms) are subject to shared interpretive jurisdiction by the Departments.

[3] For purposes of S corporations, 2-percent shareholder generally means any person who owns more than 2 percent of the stock of the S corporation. See Code §1372(b)(2).

in response to comments and questions from taxpayers and stakeholder groups about certain aspects of that guidance.

The United States Department of Labor (DOL) and the United States Department of Health and Human Services (HHS) (collectively with the Treasury Department and the IRS, the Departments) have reviewed this notice and have advised the Treasury Department and the IRS that they agree with the guidance provided in this notice.

The Treasury Department and the IRS anticipate that clarifications regarding other aspects of employer payment plans and HRAs will be provided in the near future. This notice is intended to provide further clarification of the guidance provided in Notice 2013-54 and other guidance and is intended to be read in conjunction with that guidance.

II. GUIDANCE

Question 1 (Transition Relief for Small Employers from the Code § 4980D Excise Tax): Small employers have in the past often offered their employees health coverage through arrangements that would constitute an employer payment plan as described in Notice 2013-54. If an employer offered coverage through such an arrangement, will the employer owe an excise tax under Code § 4980D?

Answer 1: In general, yes; however, this notice provides limited transition relief for coverage sponsored by an employer that is not an ALE under §§54.4980H-1(a)(4) and -2.

Notice 2013-54 concludes that the arrangements constituting employer payment plans as described in that notice fail to comply with the market reforms and may subject employers to the excise tax under Code § 4980D. At the same time, the Departments understand that some employers that had been offering health coverage through an employer payment plan may need additional time to obtain group health coverage or adopt a suitable alternative.

The SHOP Marketplace addresses many of the concerns of small employers. However, because the market is still transitioning and the transition by eligible employers to SHOP Marketplace coverage or other alternatives will take time to implement, this guidance provides that the excise tax under Code § 4980D will not be asserted for any failure to satisfy the market reforms by employer payment plans that pay, or reimburse employees for individual health policy premiums or Medicare part B or Part D premiums (1) for 2014 for employers that are not ALEs for 2014, and (2) for January 1 through June 30, 2015 for employers that are not ALEs for 2015. After June 30, 2015, such employers may be liable for the Code § 4980D excise tax.

For purposes of this Q&A-1, an ALE generally is, with respect to a calendar year, an employer that employed an average of at least 50 full-time employees (including full-time equivalent employees) on business days during the preceding calendar year. See

Code § 4980H(c)(2) and §§ 54.4980H-1(a)(4) and -2. For determining whether an entity was an ALE for 2014 and for 2015, an employer may determine its status as an applicable large employer by reference to a period of at least six consecutive calendar months, as chosen by the employer, during the 2013 calendar year for determining ALE status for 2014 and during the 2014 calendar year for determining ALE status for 2015, as applicable (rather than by reference to the entire 2013 calendar year and the entire 2014 calendar year, as applicable). See section IX.E of the preamble to the proposed regulations under § 4980H (78 FR 218, 238) (Jan. 2, 2013) and section XV.D.3 of the preamble to the final regulations under § 4980H (79 FR 8544, 8573) (Feb. 12, 2014).

Employers eligible for the relief described in this Q&A-1 that have employer payment plans are not required to file IRS Form 8928 (regarding failures to satisfy requirements for group health plans under chapter 100 of the Code, including the market reforms) solely as a result of having such arrangements for the period for which the employer is eligible for the relief. This relief does not extend to stand-alone HRAs or other arrangements to reimburse employees for medical expenses other than insurance premiums.

Question 2 (Treatment of S corporation healthcare arrangements for 2-percent shareholder-employees): IRS Notice 2008-1, 2008-2 I.R.B. 1, provides that if an S corporation pays for or reimburses premiums for individual health insurance coverage covering a 2-percent shareholder (as defined in Code § 1372(b)(2)), the payment or reimbursement is included in income but the 2-percent shareholder-employee may deduct the amount of the premiums under Code § 162(l), provided that all other eligibility criteria for deductibility under Code § 162(l) are satisfied. (This arrangement is referred to in this notice as a 2-percent shareholder-employee healthcare arrangement.) Is a 2-percent shareholder-employee healthcare arrangement subject to the market reforms?

Answer 2: The Departments are contemplating publication of additional guidance on the application of the market reforms to a 2-percent shareholder-employee healthcare arrangement. Until such guidance is issued, and in any event through the end of 2015, the excise tax under Code § 4980D will not be asserted for any failure to satisfy the market reforms by a 2-percent shareholder-employee healthcare arrangement. Further, unless and until additional guidance provides otherwise, an S corporation with a 2-percent shareholder-employee healthcare arrangement will not be required to file IRS Form 8928 (regarding failures to satisfy requirements for group health plans under chapter 100 of the Code, including the market reforms) solely as a result of having a 2-percent shareholder-employee healthcare arrangement.

The guidance provided in this Q&A-2 (including the guidance provided in the preceding paragraph) does not apply to reimbursements of individual health insurance coverage with respect to employees of an S corporation who are not 2-percent shareholders (but see Q&A-1).

The Treasury Department and the IRS are also considering whether additional guidance is needed on the federal tax treatment of 2-percent shareholder-employee healthcare arrangements. However, unless and until additional guidance provides otherwise, taxpayers may continue to rely on Notice 2008-1 with regard to the tax treatment of arrangements described therein for all federal income and employment tax purposes. To the extent that a 2-percent shareholder is allowed both the deduction under Code § 162(l) and the premium tax credit under Code § 36B, Revenue Procedure 2014-41, 2014-33 I.R.B. 364, provides guidance on computing the deduction and the credit with respect to the 2-percent shareholder.

Code § 9831(a)(2) provides that 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. Accordingly, an arrangement covering only a single employee (whether or not that employee is a 2-percent shareholder-employee) generally is not subject to the market reforms whether or not such a reimbursement arrangement otherwise constitutes a group health plan. If an S corporation maintains more than one such arrangement for different employees (whether or not 2-percent shareholder-employees), however, all such arrangements are treated as a single arrangement covering more than one employee so that the exception in Code § 9831(a)(2) does not apply. For this purpose, if both a non-2-percent shareholder employee of the S corporation and a 2-percent shareholder employee of the S corporation are receiving reimbursements for individual premiums, the arrangement would be considered a group health plan for more than one current employee. However, if an employee is covered under a reimbursement arrangement with other-than-self-only coverage (such as family coverage) and another employee is covered by that same coverage as a spouse or dependent of the first employee, the arrangement would be considered to cover only the one employee.

Question 3 (Integration of Medicare premium reimbursement arrangement and TRICARE-related HRA with a group health plan): If an employer offers to reimburse Medicare premiums for its active employees, does this arrangement create an employer payment plan under Notice 2013-54? If so, may the employer payment plan be integrated with another group health plan to satisfy the annual dollar limit and preventive services requirements? Similarly, does an arrangement under which an employer reimburses (or pays directly) some or all of medical expenses for employees covered by TRICARE constitute an HRA subject to the market reforms? If so, may the HRA be integrated with another group health plan to satisfy the annual dollar limit and preventive services requirements?

Answer 3: Medicare premium reimbursement arrangements. An arrangement under which an employer reimburses (or pays directly) some or all of Medicare Part B or Part D premiums for employees constitutes an employer payment plan, as described in Notice 2013-54, and if such an arrangement covers two or more active employees, is a group health plan subject to the market reforms. An employer payment plan may not be integrated with Medicare coverage to satisfy the market reforms because Medicare coverage is not a group health plan. However, an employer payment plan that pays for

or reimburses Medicare Part B or Part D premiums is integrated with another group health plan offered by the employer for purposes of the annual dollar limit prohibition and the preventive services requirements if (1) the employer offers a group health plan (other than the employer payment plan) to the employee that does not consist solely of excepted benefits and offers coverage providing minimum value; (2) the employee participating in the employer payment plan is actually enrolled in Medicare Parts A and B; (3) the employer payment plan is available only to employees who are enrolled in Medicare Part A and Part B or Part D; and (4) the employer payment plan is limited to reimbursement of Medicare Part B or Part D premiums and excepted benefits, including Medigap premiums. Note that to the extent such an arrangement is available to active employees, it may be subject to restrictions under other laws such as the Medicare secondary payer provisions. An employer payment plan that has fewer than two participants who are current employees (for example, a retiree-only plan) on the first day of the plan year is not subject to the market reforms and, therefore, integration is not necessary to satisfy the market reforms.

TRICARE-related HRAs. Similarly, an arrangement under which an employer reimburses (or pays directly) some or all of medical expenses for employees covered by TRICARE constitutes an HRA, and, as provided in Notice 2013-54, if such an arrangement covers two or more active employees, is a group health plan subject to the market reforms. An HRA may not be integrated with TRICARE to satisfy the market reforms because TRICARE is not a group health plan for integration purposes. However, an HRA that pays for or reimburses medical expenses for employees covered by TRICARE is integrated with another group health plan offered by the employer for purposes of the annual dollar limit prohibition and the preventive services requirements if (1) the employer offers a group health plan (other than the HRA) to the employee that does not consist solely of excepted benefits and offers coverage providing minimum value; (2) the employee participating in the HRA is actually enrolled in TRICARE; (3) the HRA is available only to employees who are enrolled in TRICARE; and (4) the HRA is limited to reimbursement of cost sharing and excepted benefits, including TRICARE supplemental premiums. Note that to the extent such an arrangement is available to active employees, employers should be aware of laws that prohibit offering financial or other incentives for TRICARE-eligible employees to decline employer-provided group health plan coverage, similar to the Medicare secondary payer rules.

Note that an employer may provide more than one type of healthcare arrangement for its employees (for example, a Medicare Part B employer payment plan and a TRICARE-related HRA), provided that each arrangement meets the applicable integration or other rules set forth in this notice or in related guidance.

Question 4 (Increases in employee compensation to assist with payments of individual market coverage): 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), is this arrangement an employer payment plan?

Answer 4: No. As described in Notice 2013-54, an employer payment plan is 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 as arrangements described in Rev. Rul. 61-146. The arrangement described in this Q&A-4 does not meet that description. In addition, because the arrangement described in this Q&A-4 generally will not constitute a group health plan, it is not subject to the market reforms.[4] Providing employees with information about the Marketplace or the premium tax credit under Code § 36B is not endorsement of a particular policy, form, or issuer of health insurance.

Question 5 (Treatment of an employer payment plan as taxable compensation): Notice 2013-54 provides that the payment arrangement described in Rev. Rul. 61-146 is an employer payment plan. May the reimbursements or payments under an arrangement described in Rev. Rul. 61-146 be provided on an after-tax basis and, if so, will this cause the arrangement not to be a group health plan (and accordingly not to be subject to the market reforms)?

Answer 5: No. Rev. Rul. 61-146 holds that under certain conditions, if an employer reimburses an employee's substantiated premiums for non-employer sponsored hospital and medical insurance, the payments are excluded from the employee's gross income under Code § 106. This exclusion also applies if the employer pays the premiums directly to the insurance company. The holding in Rev. Rul. 61-146 continues to apply, meaning only that payments under arrangements that meet the conditions set forth in Rev. Rul. 61-146 are excludable from the employee's gross income under Code § 106 (regardless of whether the employer includes the payments as wage payments on the Form W-2). However, Rev. Rul. 61-146 does not address the application of the market reforms and should not be read as containing any implication regarding the application of the market reforms. As explained in Notice 2013-54, an arrangement under which an employer provides reimbursements or payments that are dedicated to providing medical care, such as cash reimbursements for the purchase of an individual market policy, is itself a group health plan. Accordingly, the arrangement is subject to the market reform provisions of the Affordable Care Act applicable to group health plans without regard to whether the employer treats the money as pre-tax or post-tax to the employee. Such employer health care arrangements cannot be integrated with individual market policies to satisfy the market reforms and, therefore, will fail to satisfy PHS Act §§ 2711 (annual limit prohibition) and 2713 (requirement to provide cost-free preventive services) among other provisions.

[4] For more information on establishing or maintaining a group health plan under ERISA, see 29 CFR 2510.3-1(j) and the Department of Labor's Field Assistance Bulletins Nos. 2006-2 and 2004-1, available at http://www.dol.gov/ebsa/regs/fab2006-2.html and http://www.dol.gov/ebsa/regs/fab2004-1.html.

III. FOR FURTHER INFORMATION

Questions concerning the information contained in this notice may be directed to the IRS at 202-317-6846. Additional information for employers regarding the Affordable Care Act is available at www.healthcare.gov,www.dol.gov/ebsa/healthreform, and at www.business.usa.gov.

IV. DRAFTING INFORMATION

The principal author of this notice is Shad Fagerland of the Office of Associate Chief Counsel (Tax Exempt and Government Entities). For further information regarding this notice, contact Mr. Fagerland at (202) 317-5500 (not a toll-free call).