**Abstract:** For plan years beginning after 2013, the Affordable Care Act institutes so-called market reform provisions that place a whole host of new restrictions on group health plans. With a limited exception, these provisions significantly restrict an employer's ability to reimburse employees for premiums paid on individual health insurance policies, referred to as employer payment arrangements. This article explains the new restrictions on these arrangements and what employers who still have them should do. It also looks at acceptable alternatives.

## Employer reimbursements of individual health insurance policies

For plan years beginning after 2013, the Affordable Care Act (ACA) institutes so-called market reform provisions that place a whole host of new restrictions on group health plans. The penalty for violating the market reform restrictions is a punitive $100-per-day, per-employee penalty; or $36,500 per employee, per year. With a limited exception, these new market reform provisions significantly restrict an employer's ability to reimburse employees for premiums paid on individual health insurance policies, referred to as employer payment arrangements.

### Employer payment arrangements

Under employer payment arrangements, the employer reimburses employees for premiums they pay on their individual health insurance policies (or the employer sometimes pays the premium on behalf of the employee). As long as the employer (1) makes the reimbursement under a qualified medical reimbursement plan and (2) verifies that the reimbursement was spent only for insurance coverage, the premium reimbursement is excludable from the employee's taxable income. These arrangements have long been popular with small employers who want to offer health insurance but are unwilling or unable to purchase group health coverage.

Unfortunately, according to the IRS and Department of Labor (DOL), group health plans can't be integrated with individual market policies to meet the new market reform provisions. Furthermore, according to the DOL, an employer that reimburses employees for individual policies (on a pretax or after-tax basis) has established a group health plan because the arrangement's purpose is to provide medical care to its employees. Therefore, reimbursing employees for premiums paid on individual policies violates the market reform provisions, potentially subjecting the employer to a $100 per-day, per-employee ($36,500 per year, per employee) penalty.

***Limited exception for one-employee plans.*** The market reform provisions do not apply to group health plans that have only one participating employee. Therefore, it is still allowable to provide an employer payment arrangement that covers only one employee. Note, however, that nondiscrimination rules require that essentially all full-time employees must participate in the plan.

***Bottom line.*** While still technically allowed under the tax code, employer payment arrangements, other than arrangements covering only one employee, are no longer a viable alternative.

### What should you do if you still have an employer payment plan?

First of all, don't panic. You are not alone. The impact of the market reform provisions to these plans has come as a great surprise to many small business employers, not to mention the tax practitioner community, and we believe there is reasonable cause to keep the penalty from applying for earlier payments. However, it is important to discontinue making payments under the plan and rescind any written documents. Also, any reimbursements made after 2013 should be classified as taxable wages.

**Acceptable alternatives**

Because of the ACA market reform requirements, employers are basically precluded from subsidizing or reimbursing employees for individual health insurance policies if there is more than one employee participating in the plan. Employers can, however, continue to do any of the following:

- Provide a tax-free fringe benefit by purchasing an ACA-approved employer-sponsored group health plan. Small employers with 50 or fewer employees can provide a group health plan through the Small Business Health Options Plan (SHOP) Marketplace. A cafeteria plan can be set up for pretax funding of the employee portion of the premium.

- Increase the employee's taxable wages to provide funds that the employee may use to pay for individual insurance policies. However, the employer cannot require that the funds be used to pay for insurance — it must be the employee's decision to do so (or not). The employer can claim a deduction for the wages paid. The wages are taxable to the employee, but the employee can claim the premiums as an itemized deduction subject to the 10%-of-AGI limit (7.5% if age 65 or older).

If you have any questions, please give us a call.