New IRS rules for medical premiums

Effective July 1, 2015, the IRS changed the rules pertaining to medical insurance premiums reimbursed by employers to congregational employees. Reimbursed medical premiums for some church, district, and camp employees began being treated as taxable income as a result of the change.

The IRS rules for determining which medical premiums are taxable and which are exempt from tax are complicated, so it’s difficult to generalize whether a particular reimbursement arrangement will be pre- or post-tax.

The IRS has continued to face criticism over this issue, but it has not changed its mind that reimbursement of employees’ health insurance premiums creates ACA violations. However, a “one participant” arrangement is not subject to the Affordable Care Act requirements that generate financial penalties levied on those who do not comply with ACA provisions. Despite this good news, the IRS has indicated informally that the Section 105(h) nondiscrimination rules applicable to healthcare reimbursement plans will apply to one-participant premium reimbursement arrangements, which may make the reimbursements taxable.

Sound complicated? What does this mean? Here’s a couple of general principles that you can use --

First, if you only have one employee -- and no more -- working any number of hours, then you can reimburse that one employee for individual health care insurance premiums on a pre-tax basis -- and you won’t create an Affordable Care Act violation.

Second, if you have more than one employee but you only reimburse one employee, working any number of hours, and the other employees work less than 25 hours per week on a regular basis, the section 105(h) rules won’t be violated as a result of that reimbursement, and the reimbursements are not taxable.

Third, if the person you are reimbursing is not among the highest paid 25 percent of all employees, the section 105(h) rules won’t be violated as a result of that reimbursement, and it can also be provided pre-tax.

Beyond that, the Section 105(h) rules are more difficult to apply. Employees under age 25 can be excluded from Section 105(h) testing, as can employees who have not completed three years of service at the beginning of a “plan year.” If you don’t fit under the “only one employee” or “not in the highest paid 25 percent of all employees” examples given above, you may still be able to pass section 105(h) testing and provide the reimbursement on a pre-tax basis.

BBT is providing this information as a service, but we cannot provide guidance beyond what is outlined here. Few employment situations are alike, and penalties for non-compliance are significant. Thus, to ensure that employees are limiting their tax burden while remaining compliant with ACA and IRS regulations, it is important for each congregation and/or organization to consult with the attorney or accountant who advises your church on tax matters.

We hope you find this information helpful; please feel free to share it. If you know someone who would like to be informed of news like this in the future, please have them email Jean Bednar at jbednar@cobbt.org and request to be added to our BBT Alert email list.