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IRS Wellness Program Etiquette – Don’t Double Dip

A recent IRS memorandum discusses the tax treatment of certain wellness programs and incentives that include cash rewards and reimbursements of wellness program premiums that are paid on a pretax basis. Among other things, the memorandum addresses program designs that recently have been marketed to employers as a way to provide tax-free benefits to employees by reimbursing (on a tax-free basis) wellness program premiums paid with (pretax) salary reduction dollars. This kind of “double dipping” offers a benefit scheme that might be too good to be true. Employers contemplating such arrangements should consult with their tax advisors.

Background

Benefits provided to employees are included in their taxable income (and subject to income and employment taxes) unless specifically excluded from taxation under the Internal Revenue Code (Code). Employer-provided group health plan coverage and reimbursements of qualified medical expenses are benefits that are excluded from employees’ gross income and employment taxes under Sections 106 and 105 of the Code, respectively. “De minimis” fringe benefits are also excludable from gross income under Code Section 132. A de minimis fringe benefit is any property or service, the value of which is so small as to make accounting for it unreasonable or administratively impracticable.

Wellness programs can be, among other things, a component of a health plan or provided as a stand-alone group health plan. Thus, coverage by an employer’s wellness program that provides medical care can be excluded from an employee’s gross income, and contributions for such coverage may be made on a pretax basis through a cafeteria plan. Rewards or benefits provided by the wellness program can be nontaxable benefits, like reimbursement of qualified medical expenses, reduced healthcare premiums, deductibles, copays or contributions to an account-based plan — e.g., a health savings account (HSA), health flexible spending arrangement (FSA) or health reimbursement arrangement (HRA). Other rewards or benefits — such as cash awards, gift cards or certificates, and gym memberships — are taxable. The IRS treats gift certificates and coupons, which have a face value, as cash equivalents includable in the employee’s gross income and subject to income and employment taxes.

Revenue Ruling 2002-3 provides that (pretax) salary reduction amounts that are used to pay for a health insurance premium also may not be reimbursed under an employer plan on a tax-free basis. This concept is known in the tax world as "double dipping" — where the same dollars are excluded from taxation twice.

Tax Consequences of Certain Incentives and Reimbursements

The Chief Counsel Advice memorandum addresses three factual scenarios — all involving wellness programs that provide health screenings and other health benefits and generally qualify as health coverage. In one scenario, the program is provided at no cost to employees. In the other two scenarios, employees electing to participate pay a pretax premium through a cafeteria plan. All three programs offer rewards, such as cash and other benefits, for participation. One also rewards participants with reimbursements of all or a portion of their wellness program premiums.

Cash and Other Non-Excludable Rewards Always Taxable

The IRS reiterates that with the exception of a de minimis fringe benefit (under Section 132), any wellness reward that is not associated with a payment for healthcare (under Section 106) or a medical expense (under Section 105) is included in an employee's gross income (and subject to income and employment taxes). For example, as a de minimis fringe benefit, the value of the T-shirt an employee receives for submitting to a biometric screening at the company's health fair need not be included in the employee's gross income. Cash benefits are never excludable as de minimis benefits. Thus, wellness rewards in the form of cash or a cash equivalent (e.g., a gift card), no matter what amount, must be included in the employee's gross income.

Generally, an employer's payment of a gym membership cannot be excluded from the employee's gross income because such an expense is incurred to improve general health and well-being and would not be considered a qualified medical expense. The IRS further explains that payment of an employee's gym membership fee (that does not qualify as a medical expense) is also considered a non-excludable cash benefit. The fair market value of such a reward must be included in the employee's gross income and would be subject to income and employment taxes.

> **Comment.** Note that the fair market value of an employer-provided athletic facility located on the employer's premises (e.g., an on-site gym) could be excluded from employees' gross income if it meets certain requirements (e.g., it is operated by the employer and substantially all who use it are employees, their spouses, and dependent children).

Salary Reduction and Expense Reimbursement – No Double Dipping!

The IRS states that coverage provided by the wellness program in the three scenarios outlined in the memorandum is excluded from employees' gross income as coverage under an accident or health program. Any contribution or premium paid for coverage under the wellness program may be made on a pretax (salary reduction) basis through a cafeteria plan. In one scenario, a benefit available under the wellness program includes a reimbursement of all or a portion of the employee's salary reduction contribution to the wellness program. The IRS finds that an employer may not exclude from an employee's gross income reimbursements of premiums for participating in a wellness program, if the premiums for the program were originally made by salary reduction through a cafeteria plan.

> **Comment.** The IRS finds this wellness program design to be similar to that described in Revenue Ruling 2002-3 (discussed above). Vendors marketing this program design assert that employers can attain more significant payroll tax savings. Some contend that the design allows the wellness program to fund itself —

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the premiums paid by the employee convert to the cash reward provided for participation in the program. The IRS has again made clear that the same salary reduction dollars that are used to pay wellness program premiums may not be returned to employees as a tax-free "premium reimbursement" or other repayment. This is impermissible double dipping. While employers might find this program design inviting, they should consult with trusted advisors and consider that if something sounds too good to be true, it probably is.

In Closing

While a wellness program can be beneficial to employers and employees in many ways, it generally does not offer additional tax savings that otherwise would not be present through a typical cafeteria plan. Benefits, like cash or gym memberships, that otherwise would be includable in an employee's gross income do not become excludable if they are offered through a wellness program. The programs discussed in this IRS memorandum are less about wellness benefits and more about tax savings. Seemingly aimed at exploiting the tax-free nature of wellness and group health programs, they should be viewed cautiously.

Authors
Sharon Cohen, JD
Leslye Laderman, JD, LLM

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