Health Insurance Becomes a Taxing Experience

Who knew that the intricacies of the Affordable Care Act and the Internal Revenue Code could become such a hot topic? However, when you talk about imposing income taxes where they haven’t traditionally applied, that is going to get folks’ attention. Of course, I am referring to the articles the OTA has run recently about federal guidance interpreting Obamacare. While you may not like the bottom line, with the assistance of the Auditor of State’s Office and the IRS, I think we have clear guidance for you in this edition of the Ohio Township News. Some background is in order. I apologize in advance because this gets technical.

Health insurance was not common in America prior to World War II. In the post-war era, wage and price controls were in effect to control inflation. As a result, employers generally could not grant raises and so turned to increased fringe benefits to attract and retain talented employees. One of these job perks was employer-provided health insurance. The IRS took the position that these benefits would not be considered taxable income to the employee who received them. This position was codified in section 106 of the Internal Revenue Code that was enacted in 1954. Section 106 of the Internal Revenue Code was interpreted by the IRS in Revenue Ruling 61-146, which was issued in 1961. In this ruling, the IRS concluded that whether the employer pays the health insurance carrier directly or reimburses the employee for paying all or a portion of the health insurance premium (after receiving proof that the employee paid for health insurance), in either case, the amounts paid are not taxable income to the employee.

For a long time, Ohio township law aligned quite nicely with the Internal Revenue Code on this point. There are two sections of the Ohio Revised Code (505.60 and 505.601) that authorize townships to, among other things, reimburse township officers and employees for the out-of-pocket cost of health insurance premiums paid to obtain health insurance from a source other than the township. This option applies when the township does not provide health insurance or, if the township offers health insurance, but an officer or employee is denied coverage under the township plan, or declines the township plan and obtains health insurance from another source. Until recently, these reimbursements paid to an officer or employee would not have been taxable income under federal tax law.

Then came the enactment of an incredibly complex federal law known as the Patient Protection and Affordable Care Act (aka, Obamacare). In the fall of 2013, the IRS (IRS Notice 2013-54), the U.S. Department

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of Labor (DOL technical release 2013-03), and the Centers for Medicare and Medicaid Services issued guidance about how the Affordable Care Act impacts various types of employer health insurance models, sometimes referred to as Cafeteria Plans, Health Reimbursement Arrangements, Health Savings Accounts, Flexible Spending Accounts, etc. One scenario addressed in the guidance is “Employer Payment Plans,” which, in short, includes the process many townships have been using to reimburse officials and employees for their out-of-pocket premium costs for health insurance obtained elsewhere (described above). The guidance concluded that these Employer Payment Plans are “group health plans” within the meaning of the Affordable Care Act and consequently must meet the “market reforms” contained in the federal law.

There are two reforms which Employer Payment Plans cannot meet. The first is the Obamacare provision which states that a group health plan cannot place an annual limit on the dollar amount a person receives in health benefits. Apparently the feds believe that reimbursing just for out-of-pocket premium expense is a type of annual limit on health benefits. The second market reform requires group health plans to provide certain preventative services without imposing any costs on the insured. (These preventative measures include things like vaccinations, blood pressure screening, cholesterol screening, diet counseling, tobacco use counseling, etc.) The IRS asserts that Employer Payment Plans cannot meet this market reform because they do not completely pay for all these preventive measures in all instances.

Consequently, according to the IRS, the only way to continue an Employer Payment Plan and not run afoul of Obamacare is to make the reimbursements to the official or employee taxable income. This interpretation of the Affordable Care Act went into effect Jan. 1, 2014. While some aspects of Obamacare have been delayed, this is not one of them. We have received a lot of calls about this, particularly the $100 per day per individual penalty that can apply. Obviously, I cannot speak for the IRS about their penalty. However, I would note that the IRS just came out with additional guidance on this on May 13. That guidance did not alter the result; it was more a reinforcement of the law. Given that, I would be surprised if a township doing its best to implement this change during 2014 would face the stiff penalty.

Believe it or not, this is a simplification of a complex subject. A complete description of every nuance of this subject is beyond the scope of this column. Consult an accountant, health insurance expert or tax attorney if you wish to explore this issue in greater detail.
Health Care Reimbursement Guidance for Townships

By: Robert Cupp, Chief Legal Counsel, Ohio Auditor of State’s Office, and Brendan Inscho, Deputy Chief Legal Counsel, Ohio Auditor of State’s Office

Many township officials have contacted the Auditor of State’s Office (AOS) with questions concerning the “Health care reimbursements changing with ACA” article in the recent Ohio Township Association’s Grassroots Clippings. While this office is willing to provide some guidance on these matters, townships should consult the IRS regarding federal tax issues. Any questions relating to the Ohio Public Employees Retirement System (OPERS) should be directed to that agency. The AOS does not specialize in these matters and has no authority to speak on behalf of the IRS or OPERS.

Having said that, we understand many townships reimburse individuals’ out-of-pocket health care premiums (i.e., premiums paid for non-township-sponsored plans). It is appropriate, therefore, for the AOS to provide some guidance on these important matters. Below are the most frequently asked questions posed to the AOS regarding township health care under the Affordable Care Act (ACA), with AOS responses:

**Does the ACA require that townships withhold income taxes prior to reimbursing officers and employees for their health care premiums?**

The short answer is “yes.” As explained in IRS Notice 2013-54 and Department of Labor Technical Release 2013-03, employers may only reimburse employees’ premiums for non-employer sponsored health care with post-tax dollars (i.e., employers must withhold taxes prior to making reimbursement).

In that case, must fiscal officers also withhold OPERS contributions for those dollars?

This ultimately is a determination for OPERS to make. Whether compensation qualifies as “earnable salary” and is subject to OPERS withholding is governed by RC 145.01 “Definitions” and OAC 145-1-26 “Definition of earnable salary.” RC 145.01(R)(2) states “‘Earnable salary’ does not include any of the following ... (b) Amounts paid by the employer to provide life insurance, sickness, accident, endowment, health, medical, hospital, dental, or surgical coverage, or other insurance for the contributor or the contributor’s family, or amounts paid by the employer to the contributor in lieu of providing the insurance.” OAC 145-1-26(G)(5) further explains the following are not considered “earnable salary” . . . “(5) Monetary amounts that are in excess of the employee’s gross salary paid in lieu of a fringe benefit or a cash value placed on that fringe benefit.” If an employer is unsure whether an amount is OPERS earnable salary, the employer should request a determination from OPERS.

Will AOS issue findings for recovery if the amounts earned as post-tax health care reimbursement cause township trustees’ or fiscal officers’ “gross salary,” as it appears on income tax forms, to exceed the maximum salary permitted under the Revised Code?

Nothing has changed under the Revised Code to change the nature of health care reimbursement from a fringe benefit to salary. Salary is provided for trustees and fiscal officers under RC 505.24 and 507.09, respectively, while township health care is provided for separately at RC 505.60 through 505.603. Accordingly, assuming that trustees and fiscal officers earn no more than permitted under RC 505.24 and 507.09, the AOS will not issue findings for recovery because the health care reimbursement amounts must be reported as income in response to the change in federal law.

Is there a $100 per day penalty for failing to comply with the ACA?

In general, yes, failure to comply with the ACA results in a $100 per day penalty. This penalty applies per person. Townships could owe the IRS $36,500 per year for every employee whose health care premiums are reimbursed with pre-tax dollars. Townships that have failed to withhold taxes still may avoid the penalty, subject to the following: (1) beginning on the first day a township knew or should have known of the error, the township corrected the error within 30 days; and (2) the township files IRS Form 8928 (found at www.irs.gov/pub/irs-pdf/f8928.pdf).

How should townships account for health care reimbursements in UAN? Please refer to the following link for instructions on how to account for post-tax health care reimbursement in UAN: www.uanlink.ohioauditor.gov/pdf/communications/UAN_Instructions_for_Healthcare.pdf.