

UPDATED TAX DEVELOPMENT – (PLEASE NOTE THAT THIS ARTICLE IS UPDATED WITH NEW INFORMATION REGARDING PENALTIES CONCERNING REIMBURSEMENT OF PREMIUM COSTS)**No Reimbursement of Certain Health Insurance Policies
with Pre-Tax or After-Tax Dollars**

While most churches thought that they were exempt from the major impacts of the Affordable Care Act (often called “ACA” or “ObamaCare”), a seemingly innocuous Internal Revenue Service notice, issued in September 2013, has been interpreted to place many churches and businesses in the crossfire of the Affordable Care Act. As clarification has been sought on this provision, the regulations seem to have only brought about more onerous interpretations.

According to IRS Notice 2013-54, employers may no longer reimburse employees for, or directly pay, the cost of *individual* health insurance policy premiums and exclude such amounts from the employee’s gross income. Effective January 1, 2014, these “employer payment plans” must be paid with “after tax” dollars, rather than with “pre-tax” dollars, and cannot be a “reimbursement.” The employer is only allowed to use “pre-tax” dollars to pay for health insurance premiums if the employer offers a *group* health insurance plan.

Further, [more recent guidance](#), issued within the last few weeks, has suggested that “reimbursement” by an employer of an *individual* health insurance policy premium creates a non-compliant health care plan under the Affordable Care Act – and therefore subjects the employer to a **\$100 per day penalty**, per employee. According to this recent guidance, an employer/church who reimburses a pastor or staff member for their individual health insurance policy premium, *even if such is subject to taxes*, has violated the Affordable Care Act and is subject to \$36,500 a year in penalties, per employee.

While an employer/church can increase an employee’s salary to cover the costs of that employee’s individual insurance policy – and can even increase the amount to cover additional taxes, it should not be deemed as reimbursement of the employee’s individual health insurance policy premiums, nor should the employer/church request verification of the insurance premium costs. If the insurance premium notice is requested or provided, the U.S. Department of Labor’s recent guidance suggests that such creates a non-compliant group health plan and triggers the penalties mentioned above.

Since an IRS revenue ruling in 1961, churches and businesses have been able to structure compensation plans where employees could obtain their own individual health care plan, provide documentation and substantiation of such to the employer, and the employer could reimburse the employee for, or directly pay, the cost of the individual health insurance policy premiums and such amounts were excluded from the employee’s gross income. Under IRS Notice 2013-54, the Affordable Care Act no longer allows such an arrangement to occur with pre-tax dollars or even with after-tax dollars if such is deemed reimbursement. An employer can still withhold funds and transmit those to pay the premiums on the individual health insurance policy, as a convenience to the employee, but the amounts must come from after-tax funds and cannot be reimbursements.

Consider the following examples:

- 1.) A local church agrees to pay a pastor \$40,000 a year salary, plus pay another \$10,000 a year towards the pastor's individual health insurance premium. According to IRS Notice 2013-54, the pastor would have taxable income of \$50,000 in the year in question. It should be noted that the amount designated for insurance must be taxed whether the pastor has secured the health insurance independently or through the government-operated Health Care Exchange. Further, the pastor should not submit nor should the church require documentation of the pastor's individual health insurance premium costs.
- 2.) A pastor's wife has health insurance through a *group* plan at her employment and her company pays the entirety of her premium. Such amounts paid by her company are not taxable income to her since she is covered by a *group* plan that meets the requirements of the Affordable Care Act. In addition, her company offers full family coverage but the employee must pay the difference between the company provided employee group coverage and the family coverage premium. If the pastor's church offers to pay the additional \$500 per month to cover the pastor and the pastor's children, the \$500 per month is taxable income to the pastor. If documentation of the costs is requested or submitted, the church may be subject to the penalties discussed earlier.

As noted above, IRS Notice 2013-54 took effect January 1, 2014. Therefore, any additional amounts paid by a church to a pastor or staff member for that person's individual health insurance plan must be treated as taxable income. Treating such amounts as taxable income means that the amounts are subject to federal income taxes, state income taxes, and self-employment taxes (Social Security and Medicare taxes). Using example one above, and assuming a 20% federal income tax bracket, the pastor would be subject to federal income taxes of \$2,000, plus SECA taxes of \$1,530, as well as any state income taxes.

Because the Affordable Care Act has converted the policy premium payments from pre-tax to after-tax funds for individual health insurance plans, the self-employed minister stands to lose forty or so percent of this benefit that was previously considered a fringe benefit, assuming state taxes are due.

While these rules are currently in place and effective, the conversations with Congress, the U.S. Department of Treasury, the U.S. Department of Labor, and the Internal Revenue Service have continued as we have tried to eliminate this onerous burden created by the Affordable Care Act. However, those efforts have been unsuccessful, and in fact, the most recent guidance has made the impact of the Act even more challenging. The Internal Revenue Service continues to contend that the new procedure is necessary to prevent "double dipping" from a person receiving insurance premiums paid with pre-tax dollars and additionally the new "premium tax credit" available under the Affordable Care Act.

Therefore, the bottom line is that churches may no longer reimburse employees for, or directly pay, the cost of *individual* health insurance policy premiums with either pre-tax or after-tax dollars. If the church wants to assist a pastor or staff member in paying for their individual health insurance policy costs, the church may raise the person's salary, the church may not request or receive documentation of the premium costs, and the church must include such additional compensation in the employee's gross income.

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