



June 17, 2015

The Honorable Orrin G. Hatch, Chairman  
Senate Committee on Finance  
219 Dirksen Senate Office Building  
Washington, DC 20510

The Honorable Paul Ryan, Chairman  
House Committee on Ways and Means  
1102 Longworth House Office Building  
Washington, DC 20515

The Honorable Ron Wyden, Ranking Member  
Senate Committee on Finance  
219 Dirksen Senate Office Building  
Washington, DC 20510

The Honorable Sander M. Levin, Ranking Member  
House Committee on Ways and Means  
1102 Longworth House Office Building  
Washington, DC 20515

RE: Exemption Needed for Certain Types of Health Reimbursement Arrangements from the Group Health Insurance Requirements of the Patient Protection and Affordable Care Act

Dear Chairmen and Ranking Members:

The American Institute of Certified Public Accountants (AICPA) is writing to urge Congress to enact legislation to exempt employer payment plans, as well as similar arrangements provided to partners, more than two-percent shareholders of S corporations and sole proprietors, from the group health insurance requirements of the Patient Protection and Affordable Care Act<sup>1</sup> (“Affordable Care Act”).

This letter was developed by the Health Care Tax Task Force of the AICPA Employee Benefits Tax Technical Resource Panel, and approved by the Tax Executive Committee.

The AICPA is the world’s largest member association representing the accounting profession, with more than 400,000 members in 145 countries and a history of serving the public interest since 1877. Our members advise clients on federal, state and international tax matters and prepare income and other tax returns for millions of Americans. Our members provide services to individuals, not-for-profit organizations, small and medium-sized businesses, as well as America’s largest businesses.

### **Background**

A health reimbursement arrangement (HRA) is an employer-funded arrangement that reimburses an employee for medical care expenses, including premiums for health coverage, incurred by an employee, on behalf of the employee’s spouse, dependents, and any other person. An employer payment plan is a formal or informal arrangement, including an HRA, under which the sole benefit to the employee is direct

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<sup>1</sup> The Patient Protection and Affordable Care Act was enacted on March 23, 2010, Pub. L. No. 111-148. It was amended by the Health Care and Education Reconciliation Act of 2010, as enacted on March 30, 2010, Pub. L. No. 111-152. It was further amended by the Department of Defense and Full-Year Continuing Appropriations Act, 2011, as enacted on April 15, 2011, Pub. L. No. 112-10.

The Honorable Orrin G. Hatch  
The Honorable Paul Ryan  
The Honorable Ron Wyden  
The Honorable Sander M. Levin  
June 17, 2015  
Page 2 of 6

payment or reimbursement by the employer of the employee's premiums for health coverage. The coverage is generally obtained by the employee through the individual market, a spouse's employer, through Medicare, or a former employer under the requirements of the Consolidated Omnibus Budget Reconciliation Act (COBRA). These arrangements have been in place for many years, as evidenced by Revenue Ruling 61-146, issued by the Internal Revenue Service (IRS) in 1961, which is still in effect and addresses the tax treatment of these arrangements. Additionally, similar arrangements are provided to partners and more than two-percent shareholders of S corporations where the partnership or S corporation pays for or reimburses the partner or shareholder for health insurance premiums. Sole proprietors may also participate in an arrangement similar to an employer payment plan. All of these arrangements are collectively referred to as "the Arrangements."

The Affordable Care Act includes certain market reforms that apply to group health plans.<sup>2</sup> On September 13, 2013, the U.S. Department of the Treasury ("Treasury") and the IRS issued Notice 2013-54<sup>3</sup> (the "2013 Notice") clarifying the impact of the market reforms on HRAs, including employer payment plans. The Department of Labor (DOL) issued identical guidance by way of DOL Technical Release 2013-03<sup>4</sup> ("DOL Technical Release"). Additionally, the Department of Health and Human Services (HHS) stated that it concurred with the rules of the Notice and DOL Technical Release related to the impact on these types of arrangements, with their release of Insurance Standard Bulletin Series – Information.<sup>5</sup> Treasury and the IRS also issued Notice 2015-17<sup>6</sup> (the "2015 Notice") to provide transition relief from the Internal Revenue Code (IRC) section 4980D excise tax until June 30, 2015 for small employers offering employer payment plans and until further guidance is issued for S corporations offering similar arrangements to greater than two-percent shareholder-employees. For purposes of this letter, the 2013 Notice, 2015 Notice, DOL Technical Release, and related guidance issued by HHS will be collectively referred to as "the Guidance."

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<sup>2</sup> Public Health Service Act (PHS Act) sections 2711-2719 were added by section 1001 of the Affordable Care Act. Internal Revenue Code (IRC) section 9815(a) and Employee Retirement Income Security Act (ERISA) section 715(a) were added by section 1563 of the Affordable Care Act (as amended by section 10107(b) of the Affordable Care Act) in order to integrate the provisions of part A of title XXVII of the PHS Act into the IRC and ERISA and mandate that they are applicable to group health plans and health insurance issuers providing health insurance coverage in connection with group health plans.

<sup>3</sup> IRS [Notice 2013-54](#) refers to Application of Market Reform and other Provisions of the Affordable Care Act to HRAs, Health FSAs, and Certain other Employer Healthcare Arrangements, issued on September 13, 2013 and effective January 1, 2014.

<sup>4</sup> [DOL Technical Release 2013-3](#) refers to Application of Market Reform and other Provisions of the Affordable Care Act to HRAs, Health FSAs, and Certain other Employer Health Arrangements, issued on September 13, 2013 and effective January 1, 2014.

<sup>5</sup> <https://www.cms.gov/CCIIO/Resources/Regulations-and-Guidance/Downloads/cms-hra-notice-9-16-2013.pdf>.

<sup>6</sup> IRS Notice 2015-17 refers to Guidance on the Application of Code §4980D to Certain Types of Health Coverage Reimbursement Arrangements.

The Honorable Orrin G. Hatch  
The Honorable Paul Ryan  
The Honorable Ron Wyden  
The Honorable Sander M. Levin  
June 17, 2015  
Page 3 of 6

### **AICPA Proposal**

The AICPA urges Congress to enact legislation to enable all businesses to continue to provide employer payment plans to their employees, partners, more than two-percent shareholder-employees of S corporations, and sole proprietors.

### **Analysis**

As of January 1, 2014 (except as extended in certain circumstances per Notice 2015-17), the effective date of the Guidance, employer payment plans and similar arrangements for non-employees are considered group health plans subject to the market reform rules of the Affordable Care Act. Among other restrictions, the market reform rules prohibit annual or lifetime limitations on benefits and require coverage of preventative services. Since employer payment plans and similar arrangements for non-employees routinely provide for maximum dollar limitations on benefits, they violate the market reform rules.

Employers in violation of the rules are subject to the IRC section 4980D<sup>7</sup> nondeductible excise tax of \$100 per-employee, per-day, (\$36,500 per year) for each individual reimbursed under one of these arrangements. The penalty is self-reported on IRS Form 8928, *Return of Certain Excise Taxes Under Chapter 43 of the Internal Revenue Code*.

Historically, employer payment plans have been used by employers to reimburse employees, their spouses and dependent children, for health insurance premiums, or to pay their health insurance premiums directly to the insurer on behalf of the employee. Businesses have also made available similar arrangements for partners in a partnership, shareholders of an S corporation who own more than two-percent of the S corporation's stock, and sole proprietors.

Businesses offer the Arrangements to their employees, (including partners, more than two-percent S corporation shareholders and sole proprietors), to give them a medical benefit by reimbursing the cost of health insurance premiums for individual policies, Medicare coverage, coverage through a spouse's employer, or through a previous employer under the COBRA rules. The Arrangements allow employers to mitigate health costs while providing a significant benefit to their employees. By offering this valuable benefit, employers are better able to recruit and retain high quality employees and stay competitive as benefits are an important part of an employee's overall compensation package.

In addition, employer payment plans provide tax benefits to both the employer and the employees covered under the arrangements. Most employers receive a tax deduction for the amount of the reimbursement or payment under an employer payment plan. Employees of both for profit and non-profit organizations may

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<sup>7</sup> All section references in this letter are to the Internal Revenue Code of 1986, as amended, or the Treasury Regulations promulgated thereunder.

The Honorable Orrin G. Hatch  
The Honorable Paul Ryan  
The Honorable Ron Wyden  
The Honorable Sander M. Levin  
June 17, 2015  
Page 4 of 6

receive a tax benefit as they are typically not required to include the amount of the reimbursement or payment in gross income. Tax benefits are also available for the payment or reimbursement of health insurance costs paid by partnerships, S corporations and sole proprietorships.

The AICPA believes the Arrangements support the objective of Congress by expanding affordable health care coverage to employees, partners, more than two-percent S corporation shareholders and sole proprietors by subsidizing the cost of their health coverage. However, in order to avoid the imposition of the excise tax, the amount of which can be catastrophic, many employers have eliminated these arrangements. This result is contrary to the objective of the Affordable Care Act to expand affordable health care coverage to all Americans.

#### Limited Exceptions to the Guidance

The AICPA believes that although the statute and Guidance provide for the following limited exceptions which allow employers to offer employer payment plans and HRAs without violating the market reforms of the Affordable Care Act, they are too narrow in scope:

1. One Employee Plan – Businesses that have only one active employee participating in the arrangement are permitted to offer an HRA or employer payment plan.
2. Integrated Section 105 Plan – Employers can offer section 105 plans without penalty if they are offered in addition to insurance approved under the Affordable Care Act. However, each participant in the medical reimbursement plan must be enrolled in a group health insurance plan.
3. Retiree-only Medical Reimbursement Plan – Plans that cover only retired employees are not subject to the market reforms.
4. Ancillary Benefits Only Plan – Employers are still permitted to offer section 105 plans for ancillary benefits (e.g., dental and vision coverage, long-term care and disability coverage) since these types of plans are not considered part of essential health benefits.
5. More Than Two-Percent S Corporation Shareholders – Certain arrangements under which an S corporation pays for or reimburses premiums for individual health insurance coverage covering a more than two-percent shareholder. However, the exemption is applicable only until Treasury and the IRS publish additional guidance.
6. Small Employer Payment Plans Through June 30, 2015 – Employer Payment Plans provided by small employers. However, this exemption sunsets on July 1, 2015.

The Honorable Orrin G. Hatch  
The Honorable Paul Ryan  
The Honorable Ron Wyden  
The Honorable Sander M. Levin  
June 17, 2015  
Page 5 of 6

### Effect of the Guidance on Partners as well as Greater than Two-Percent S Corporation Shareholders

The statute and Guidance has a negative impact on partners and, if further guidance is published without additional relief, more than two-percent shareholders of S corporations.

Historically, the IRS has provided specific reporting guidance for payments for health insurance in relation to partners of partnerships as well as greater than two-percent shareholders of S corporations. In Revenue Ruling 91-26, the IRS addressed the treatment of health insurance premiums paid on behalf of a partner by a partnership, as well as more than two-percent S corporation shareholders (who are treated as partners under IRC section 1372). Further clarification of the tax treatment of these payments on behalf of two-percent S corporation shareholders was issued in Notice 2008-1. This guidance allowed partnerships and S corporations to reimburse defined individuals for the cost of health insurance obtained directly through an individual policy or Medicare coverage. Payments under these rules were made directly to the partner or more than two-percent S corporation shareholder or by paying the premiums directly to the insurer. The amount of the premiums were generally reported as either a guaranteed payment for partners or added to taxable wages for more than two-percent S corporation owners. These amounts were also excluded from Federal Insurance Contribution Act (FICA) tax pursuant to IRS Announcement 92-16.

The treatment of health insurance premium reimbursements was designed to allow partners and more than two-percent S corporation owners to be eligible for the same treatment afforded to other self-employed individuals such as sole proprietors filing Form 1040, Schedule C, *Profit or Loss from Business*, under IRC section 162(l) regarding the deductibility of self-employed health insurance premiums paid by a business.

If the partnership continues to reimburse the premiums or pay the amount of the premiums directly to the insurer, using existing IRS guidance, it will be subject to the onerous excise tax under IRC section 4980D. Notice 2015-17 provides transition relief from the section 4980D excise tax for more than two-percent S corporation shareholders until further guidance is issued.

### **Conclusion/Recommendation**

The AICPA urges Congress to enact legislation which would enable all businesses to continue the practice of providing employer payment plans to their employees, and similar arrangements to partners, more than two-percent shareholder-employees of S corporations and sole proprietors.

The AICPA believes the current statute and administrative position are negatively impacting the ability of employers to offer their employees, owners, partners and more than two-percent S corporation shareholders an important health insurance benefit. We would welcome the opportunity to meet with you to further discuss our recommendation.

The Honorable Orrin G. Hatch  
The Honorable Paul Ryan  
The Honorable Ron Wyden  
The Honorable Sander M. Levin  
June 17, 2015  
Page 6 of 6

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We appreciate the opportunity to present this legislative proposal for your consideration. If you have any questions, please me at (801) 523-1051 or [tlewis@sisna.com](mailto:tlewis@sisna.com); or Kristin Esposito, AICPA Senior Technical Manager – Tax Advocacy, at (202) 434-9241 or [kesposito@aicpa.org](mailto:kesposito@aicpa.org).

Sincerely,



Troy K. Lewis, CPA  
Chair, Tax Executive Committee

cc: The Honorable Mark Iwry, Senior Advisor to the Secretary and Deputy Assistant Secretary of Retirement and Health Policy, Department of the Treasury  
Martin Pippins, Director Customer Service and Stakeholder Relations, Affordable Care Act Office, Internal Revenue Service