IRS Memo Issued on Fixed Indemnity Health Plan Tax Treatment

Benefit Payments Taxable if Premiums Paid Pre-Tax

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The IRS defines a fixed indemnity health benefit as "a plan that pays covered individuals a specified amount of cash for the occurrence of certain health-related events, such as office visits or days in the hospital. The amount paid is *not* related to the amount of any medical expense incurred or coordinated with other health coverage." Fixed indemnity health plans include benefits for specified diseases or illnesses (e.g. cancer insurance), hospital indemnity coverage (e.g. $100 per hospital day), accident coverage, or similar coverages offered as worksite products.

WHAT YOU NEED TO KNOW…

Historically there has been confusion as to the taxation of these types of benefit payments, in great part due to the lack of relation of the benefit payable to the actual medical expense incurred. To clear up this confusion, **the IRS issued a Memorandum on January 20, 2017 that concluded an employer may *not* exclude from an employee's gross income any payments under an employer-provided fixed indemnity health plan if the value of the coverage was excluded from the employee's gross income and wages.** Thus, for an employer-provided fixed indemnity health plan:

- If an employer provides coverage on a non-contributory basis (i.e. pays for 100% of employee premiums and does not include the cost of premiums in the employee's taxable income); or
- If an employee pays for coverage on a pre-tax basis; then,
- Premium amounts should be reported on employee W-2s (Box 12, Code DD) and benefit payments from the plan must be included in the employee's gross income for tax purposes.

However, if premiums are paid for with after-tax dollars, benefits from the plan are excluded from the employee's gross income and premiums are not reportable on a Form W-2. This is a Best Practice we strongly recommend for fixed indemnity benefits.

ACTIONS TO TAKE…

1. Review administration of any fixed indemnity programs currently offered to your employees.
2. If premiums are paid on a pre-tax basis, whether 100% employer-paid and not included in employee taxable income or employee paid pre-tax, report premium amounts on W-2s and confirm with your insurer that they are handling reporting of benefit payments and/or associated taxes that should be included in an employee's gross income and wages.
3. Consider the Best Practice and pay all premiums on a post-tax basis avoiding benefit taxation.

As always, contact any member of the Sullivan Benefit Team with any questions!