

EXPERT UPDATE



EXPECT AN EXPERT

Fixed-Indemnity Benefits May be Taxable

By Shari Herrle, Director of Compliance

A Chief Counsel Advice (CCA) memorandum issued by the IRS in January concludes that benefits provided under a Fixed Indemnity Plan may not be excluded from an employee's gross income if premiums were pre-taxed through a Section 125 Cafeteria Plan or the premiums were paid by the employer. Many large employers, specifically those that distribute 250 or more W-2s, have already discontinued allowing employees to purchase voluntary hospital indemnity, accident or specific illness coverage with pre-tax contributions to avoid the need for reporting this coverage in Box 12 of the W-2. Other employers have moved away from pre-taxing certain voluntary benefits as well due to potential ERISA implications. If you are still offering Fixed Indemnity benefits on a pre-tax basis, you may want to consider making a change to post-tax contributions next Plan year.

What are Fixed Indemnity Plans?

They are insurance plans that offer a specific cash benefit payout for participants who suffer from specific illnesses or injuries, like \$200 a day while a participant is receiving cancer treatment. The benefit is a pre-determined amount on a per-period or per-accident basis, regardless of the total charges incurred by the participant.

What does the CCA illustrate?

The tax treatment of this particular type of health coverage when the benefits are offered through a taxpayer's employer has been unclear until now. The CCA, by way of its examples ("Situations"), illustrates that an employer may not exclude from an employee's gross income benefit payments made by an employer-provided fixed indemnity health plan if the premiums for the plan were paid with salary reductions through a 125 cafeteria plan or paid by the employer. It is uncertain how the employer will be made aware of what benefits have been paid under the plan so that the amount can be properly included in the employee's taxable income.

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Next Step

Although the CCA guidance is nonbinding and cannot be used as precedent, employers that are funding the premiums or allowing employees to deduct the premium cost with pre-tax dollars should consider changing their approach as the CCA concludes with the following:

“An employer may not exclude from an employee’s gross income 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.”

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