Voluntary Benefits – Compliance and Tax Considerations

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More and more employers are choosing to include "voluntary benefits" in the benefit package offered to eligible employees. Vountary benefits may include coverage for a variety of things including, but not limited to, dental, vision, life, disability, specific disease, or accidents. It is common that such benefits will be 100% employee-paid.

Are such benefits subject to compliance requirements such as ERISA and COBRA? Are there any tax considerations? Although many employers assume there are no additional compliance obligations for these types of benefits, especially when the employer is not contributing, that is not always the case. In addition, tax rules may affect the ability to pay for premiums on a tax-favored basis, and in some cases affect the taxation of benefits received. These are things the employer should understand when choosing to offer such benefits. Below is a high-level summary of these considerations.

ERISA

Most employee benefit arrangements, both group health plans and non-group health plans, are "employee welfare benefit plans" covered by ERISA, although there are exemptions for government, tribal, and church plans, as well as for employer-sponsored daycare centers. In addition, there is a safe harbor from ERISA requirements for voluntary plans when certain conditions are satisfied. The requirements of the safe harbor are fairly restrictive and may be difficult for most plans to satisfy. The requirements (found in *DOL Reg. §2510.3-1(j)*) are outlined below:

- No employer contributions are allowed. This would prohibit not only direct employer contributions, but also reimbursement of employee premium expenses (e.g. through an HRA).
- Participation must be voluntary.
- Employer's involvement must be limited. The employer's involvement must be limited to the following:
    a) Publicizing the plan (e.g. permitting insurance presentations in the workplace, acting as intermediary between employees and the insurance company, telling employees of the program's availability and directing them to the insurer for details); and
    b) Collecting premiums through payroll deductions and remitting the premiums to the insurer.

  The employer must perform these functions without endorsing the plan. The following might be considered endorsement: (i) selection of the insurance company or the coverage to be provided; (ii) association of the employer's name with a plan (e.g. using the employer's name or logo on any communications or enrollment materials; designating the employer as plan administrator, plan sponsor, or trustee; having the insurance contract issued in the employer's name; or distributing information that associates the voluntary plan with other ERISA benefits of the employer such as in the employee handbook); (iii) recommending the plan to employees; (iv) claiming ERISA applies; (v) paying premiums through a cafeteria plan; and (vi) assisting employees with claims and disputes

Determining whether the voluntary plan safe harbor applies is often difficult. Although the employer's level of involvement is key, it is not clear exactly what is considered "employer endorsement." Often it

will depend upon consideration of the facts and circumstances as a whole rather than upon one particular employer action. Employers need to decide whether it is worth trying to satisfy the criteria for the voluntary plan safe harbor. In the end, it may be easier to assume that ERISA applies and to act accordingly (e.g. prepare a plan document, distribute a summary plan description (SPD) and file a Form 5500 as applicable). Employers who offer voluntary plans often already offer other benefits subject to ERISA. Adding the voluntary plans to the list of benefits requiring ERISA compliance is typically less burdensome than ongoing monitoring of the safe harbor status. ERISA may even benefit the employer, such as through preemption from most state laws.

COBRA

Group health plans, those that provide significant medical benefits (or health care), are generally subject to federal COBRA continuation requirements. If the voluntary benefits reimburse participants for healthcare costs, COBRA would apply if the ERISA voluntary benefit safe harbor does not apply. And even if the ERISA safe harbor applies, COBRA might still apply if *"the premium charged with respect to such coverage does not increase in the event the employment relationship terminates."* In other words, if there is uncertainty about whether the ERISA safe harbor applies, and/or if the premium is discounted because of the employment relationship, the plan may be subject to COBRA if the coverage reimburses participants for healthcare costs (e.g. dental, vision, etc.). If COBRA does apply, employers should discuss with the carrier how this will be handled for such benefits.

COBRA does not apply for life, disability, long-term care insurance, or other non-health coverage. Fixed indemnity plans that provide a pre-set amount of money in the event of certain medical situations or events (e.g. $100 per day for hospital stays or a fixed payment for a certain medical condition) are generally not subject to COBRA because they are not reimbursing the actual cost of the care.

HEALTHCARE REFORM (ACA)

As with COBRA, it may be necessary to consider healthcare reform requirements if the coverage provides health care and therefore is arguably a group health plan. Any voluntary benefits that do meet the ERISA voluntary benefit safe harbor would not be subject to healthcare reform requirements. In addition, those group health plan benefits that are considered excepted benefits (e.g. most specified disease and indemnity policies) are not subject to healthcare reform requirements.

Those voluntary benefits that provide medical benefits and do not meet the ERISA voluntary benefit safe harbor or qualify as an excepted benefit would have difficulty meeting healthcare reform requirements such as the requirement to cover preventive coverage and the prohibition on annual or lifetime limits.

TAXATION

Not all benefits are allowed to be handled on a tax-favored basis under federal tax law. Others are subject to limits. For example, life insurance on the life of an employee may be provided on a tax-favored basis for a value of up to $50,000, but additional coverage must be paid for after-tax, or imputed as additional income. In addition, for some benefits, allowing the premiums to be paid on a tax-favored basis will result in any benefits paid out potentially being taxable (e.g. disability and fixed indemnity coverage). When choosing to offer voluntary benefits, whether paid for by the employer, the employee, or both, employers should ensure that taxation is handled appropriately. Although it may be attractive to offer all benefits, including voluntary benefits, through a cafeteria plan, especially for employers providing a flex credit that can be applied as desired by the employee, it may be necessary to handle some of the premiums on an after-tax basis (or impute them as additional income).