

**Office of Chief Counsel
Internal Revenue Service
memorandum**

Number: **201547006**

Release Date: 11/20/2015

CC:TEGE:EB:HW:

PRESP-116291-15

UILC: 105.00-00, 106.00-00

date: October 07, 2015

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from: Harry Beker
Chief, Health and Welfare Branch
CC:TEGE:EB:HW

subject: Employer Payment of Employee Health Insurance Coverage Provided Under a Spouse's Group Health Plan

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

ISSUE

May an employer exclude from an employee's income under section 105 or section 106 payments for the cost of health insurance coverage provided to the employee through his or her spouse's employer's group health plan?

CONCLUSION

An employer may exclude from an employee's gross income payments for the cost of health insurance coverage provided through the spouse's group health plan but only to the extent the spouse has paid for all or part of the coverage on an after-tax basis and not through salary-reduction under a section 125 cafeteria plan.

FACTS

Situation 1. A and B are married individuals. A and B work for separate employers. A's employer offers a group health plan to A that A declines. A's employer also provides an arrangement under which it will reimburse A for the cost of coverage incurred by A's spouse. B participates in B's employer's group health plan. Under B's employer's plan, an employee participating in the plan, such as B, must make either an after-tax contribution of \$100 per month for self-only insured coverage or an after-tax contribution of \$175 per month for other than self-only insured coverage. B elects other than self-only coverage to cover both B and A under B's employer's group health plan. A substantiates to A's employer that A's spouse has \$175 per month deducted from the spouse's pay on an after-tax basis, \$75 of which represents the cost of A's insured coverage. A's employer pays A \$75 per month in addition to A's other compensation.

Situation 2. Same facts as *Situation 1*, except A's employer pays A \$175 per month in addition to A's other compensation, representing B's entire after-tax contribution for coverage under B's employer's group health plan.

Situation 3. Same facts as *Situation 1*, except that B makes the contribution to B's employer's group health plan by salary reduction through B's employer's section 125 cafeteria plan. A substantiates to A's employer that A's spouse, B, contributes \$175 per month on a pre-tax basis through salary-reduction for other than self-only insured coverage under B's employer's group health plan. A's employer pays A \$75 per month in addition to A's other compensation.

Situation 4. Same facts as *Situation 1*, except that A's employer offers A health coverage under a group health plan. B (A's spouse) elects self-only insured coverage under the group health plan of B's employer and makes the \$100 per month employee contribution by salary reduction through B's employer's section 125 cafeteria plan. A substantiates to A's employer that A's spouse, B, contributes \$100 per month on a pre-tax basis through salary-reduction for self-only insured coverage under B's employer's group health plan. A's employer pays A \$100 per month in addition to A's other compensation.

Situation 5. Same facts as *Situation 1*, except that A's employer provides an arrangement under which it will contribute to a health reimbursement arrangement (A's employer's HRA) that will reimburse A for unreimbursed medical expenses, including health insurance premiums, up to \$2,100 for the year (\$175 x 12, the amount of the cost of coverage incurred by A's spouse). Employee A substantiates to A's employer that A's spouse has \$175 per month deducted from the spouse's pay on an after-tax basis, \$75 of which represents the cost of Employee A's insured coverage. A's employer's HRA reimburses Employee A \$175 per month.

Situation 6. Same facts as *Situation 5*, except that B makes the contribution to B's employer's group health plan by salary reduction through B's employer's section 125 cafeteria plan.

Situation 7. Same facts as *Situation 6*, except that A substantiates to A's employer that A and A's spouse, B, have incurred section 213 medical expenses of \$2,100 during the year other than the premium contributions by B for the health plan with B's employer, and A's employer's HRA reimburses those unreimbursed expenses. The HRA does not reimburse the premium contribution by B through salary reduction to B's employer's group health plan.

LAW AND ANALYSIS

Section 61(a)(1) of the Internal Revenue Code and section 1.61-21(a)(3) of the Income Tax Regulations provide that, except as otherwise provided in subtitle A, gross income includes compensation for services, including fees, commissions, fringe benefits, and similar items.

Section 106 provides that "gross income of an employee does not include employer-provided coverage under an accident or health plan." Section 1.106-1 provides that the gross income of an employee does not include contributions which the employee's employer makes to an accident or health plan for compensation (through insurance or otherwise) for personal injuries or sickness to the employee or the employee's spouse or dependents (as defined in section 152).

Section 105(e) states that amounts received under an accident or health plan for employees are treated as amounts received through accident or health insurance for purposes of section 105. Section 1.105-5(a) provides that an accident or health plan is an arrangement for the payment of amounts to employees in the event of personal injuries or sickness.

Under section 125, an employer may establish a cafeteria plan that permits an employee to choose among two or more benefits, consisting of cash (generally, salary) and qualified benefits, including accident or health coverage. Pursuant to section 125, the amount of an employee's salary reduction applied to purchase such coverage is not included in gross income, even though it was available to the employee and the employee could have chosen to receive cash instead.

To the extent amounts are excluded from gross income under section 106(a), they are also excluded from wages subject to income tax withholding under section 3401. In addition, amounts paid, under a plan or system established by an employer that makes provision for the employer's employees generally (or for the employees generally and their spouses and dependents) or for a class or classes of the employer's employees (or for a class or classes of the employer's employees and their spouses and dependents), to reimburse medical expenses incurred are excluded from wages subject to FICA and FUTA taxes under sections 3121(a)(2) and 3306(b)(2).

DISCUSSION

In *Situation 1* and *Situation 2*, A's employer pays A for all or part of the substantiated cost of insured health coverage paid by B (A's spouse) on an after-tax basis under B's employer's group health plan (that is, either \$75 or \$175 per month). These amounts are excluded from A's gross income under section 106 because A's employer is paying the premium (or a portion of the premium) on a group health plan covering one or more employees, the employee's spouse and dependents, or by contributing to a separate trust or fund, which provides accident or health benefits directly or through insurance to one or more employees, the employees' spouse and dependents. The payments are also excluded from FICA taxes, FUTA taxes, and Federal income tax withholding. The fact that the insured group health plan is provided by B's employer and not A's employer does not change the result under these facts.

In *Situation 3* and *Situation 4*, the amount paid for the insured health coverage by B (A's spouse) through salary-reduction under a section 125 cafeteria plan has been excluded from the spouse's gross income. An employer may not exclude from gross income under section 106 an amount paid to an employee for insured health coverage that has already been excluded from gross income as employer-provided coverage (including salary-reduction amounts pursuant to a section 125 cafeteria plan). See Rev. Rul. 2002-3, 2002-3 IRB 316, providing that the exclusion from gross income under section 106(a) do not apply to amounts that an employer pays employees for health insurance coverage that have already been excluded from gross income under section 106(a) (including salary reduction amounts pursuant to a section 125 cafeteria plan). Accordingly, the arrangement under which A's employer makes payments to A fails to be a health plan and no amounts paid under the arrangement to any participant are excluded from the gross income under section 105. The amounts paid under the arrangement to A and other participants are also subject to FICA taxes, FUTA taxes, and Federal income tax withholding.

In *Situation 5*, A's employer's HRA pays A for all of the substantiated cost of insured health coverage paid by B (A's spouse) on an after-tax basis under B's employer's group health plan (that is, \$175 per month). These amounts are excluded from A's gross income under section 106 because A's employer is paying the premium on a group health plan covering one or more employees, the employee's spouse and dependents, or by contributing to a separate trust or fund, which provides accident or health benefits directly or through insurance to one or more employees, the employees' spouse and dependents. The payments are also excluded from FICA taxes, FUTA taxes, and Federal income tax withholding. The fact that the insured group health plan is provided by B's employer and not A's employer does not change the result under these facts.

In *Situation 6*, the amount paid for the insured health coverage by B (A's spouse) through salary-reduction under a section 125 cafeteria plan has been excluded from B's gross income. An HRA may not reimburse an amount paid to an employee for insured health coverage that has already been excluded from gross income as employer-provided coverage (including salary-reduction amounts pursuant to a section 125 cafeteria plan). See Rev. Rul. 2002-3, 2002-3 IRB 316. Accordingly, A's employer's

HRA fails to be a health plan and no amounts paid by the HRA to any participant are excluded from the gross income under section 105. The amounts paid by the HRA to participants are also subject to FICA taxes, FUTA taxes, and Federal income tax withholding.

In *Situation 7*, A's employer's HRA only reimburses amounts representing unreimbursed section 213(d) medical expenses. The amounts are excluded from A's gross income under section 105(b) and also excluded from FICA taxes, FUTA taxes, and Federal income tax withholding. The fact that the maximum amount reimbursed under the HRA is the same amount as the contributions by B for coverage under B's employer's plan is irrelevant.

Please call me at (202) 317-5500 if you have any further questions.