EM Connections

Euclid Managers Compliance Resources

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IRS Confirms Certain "Wellness" Programs Cannot Be Used to Avoid Taxation

Over the past several years, the employer-plan marketplace has seen a rise in "fixed-indemnity wellness policies," which promise to help both employers and employees save on income and employment taxes. Under these arrangements, employees elect to defer cash on a pre-tax basis through a Section 125 cafeteria plan and then receive reimbursements (that are not taxed) through their employer for participating in certain "wellness-related" activities. In many cases, these arrangements cost the employee very little (if any) effort or money. In a memo released on June 9, 2023, the IRS Office of Chief Counsel indicated that this strategy is too good to be true, concluding that fixed indemnity plans cannot be used to avoid taxation if the employee does not have unreimbursed medical expenses related to the payment.

This kind of IRS memo is known as a "letter ruling," which in this case was used to determine the legality of a specific group health plan that includes a fixed indemnity "wellness arrangement." In the wellness arrangement described in the memo, cash payments were made to employees for activities like receiving preventive care (such as vaccinations). However, all the services triggering the payments were also covered at no cost by the group's major medical plan and the fixed-dollar indemnity policy. This means that the employees received cash payments for medical care even though they did not have any unreimbursed medical expenses associated with that care. This payment structure is very different from traditional medical indemnity policies, which are based on a specific event, such as a cancer diagnosis or hospitalization, and provide beneficiaries cash payments to compensate for *unreimbursed* medical costs. Accordingly, the memo from the Office of the IRS Chief Counsel concludes that the "wellness" policy under review is impermissible because "the activity that triggers the payment does not cost the employee anything or…the cost of the activity is reimbursed by other coverage."

While this IRS memo is directed at a specific employer group plan and may not technically be used or cited as legal precedent for other plans, the fact that it was publicly released shows that the IRS wants to send a message to others. This memo serves as a strong warning that programs such as the one described above, which seem "too good to be true," typically are, and therefore should be avoided.