NEWFRONT

Fringe Benefits for Employers

2024 Edition

Audio

Presented by: **Brian Gilmore | Lead Benefits Counsel, VP**

Guide Topics

Fringe Benefits: The Big Picture

The Supplemental Benefits that Continue to Grow in Popularity

- “Fringe benefit” is a term with no precise definition or standard use
- For purposes of this guide, “fringe benefit” refers to benefits that employers offer on the “fringe” of their primary medical, dental, vision, FSA, HSA, GTL, STD, LTD, and EAP benefit offerings
- In other words, these are supplemental-type benefits designed to recruit and retain employees by providing additional levels and types of benefits beyond the standard health and welfare offerings
- Employers are increasingly putting more focus on fringe benefits as they offer employers the ability to customize benefits and target needs more than the typical off-the-shelf insurance product or most standard health and welfare (H&W) benefits

Fringe Benefits for Employers Topics for Discussion:

1. **Specialty HRAs:** Providing additional benefits such as infertility, transgender, abortion, medical travel
2. **Lifestyle Spending Accounts:** Covering common, non-medical expenses incurred during ordinary life
3. **Commuter Benefits:** A tax-advantaged way for employees to pay for mass transit and parking expenses
4. **Educational Assistance:** Tax-free reimbursement of tuition, books, fees, supplies, and student loans
5. **Adoption Assistance:** Exclusion from income for employee adoption costs up to the §137 limit

01

Specialty HRAs

Infertility and More

Specialty HRAs: What and Why?

Employers often want to reimburse employees' medical expenses in areas where the major medical plan is commonly viewed as insufficient by many employees.

Why is the Specialty HRA Needed?

- Employers cannot reimburse a §213(d) medical expense outside of a group health plan
- Reimbursement of a medical expense creates a group health plan (GHP) that has to comply with the full array of group health plan laws
- GHP laws that apply include ERISA, COBRA, HIPAA, ACA, §105(h), HSA eligibility, PCORI
- Whether the employer formally recognizes it or not, employers would effectively create a new group health plan anytime they reimbursed a medical expenses without formal plan documentation
- IRS Publication 502 provides a useful summary of expenses that qualify as a §213(d) medical expense
- HRAs are defined contribution, account-based plans that can solve for these GHP compliance burdens

What is a Specialty HRA?

- Specialty HRAs are designed to cover a specific (or multiple types of specific) health expense that is typically not adequately covered by the medical plan
- Commonly designed to cover infertility, mental health, gender reassignment surgery, abortion, medical travel costs, and/or autism expenses
- HRAs must be exclusively employer-funded
- Typically there will be an annual and lifetime limit placed on the benefit (e.g., $10,000/$25,000)
- The HRA is a group health plan subject to ERISA that needs a plan document and SPD
- Employers will want to work with a third-party administrator (TPA) to manage the HRA operations and ensure compliance with the multiple group health plan laws that apply and prepare plan document/SPD

ACA Background:
Prior Individual Coverage Guidance

The Friday the 13th Guidance (September 13, 2013)

IRS Notice 2013-54; DOL Technical Release 2013-03

- The beginning of a long series of (particularly IRS) guidance confirming the ACA prohibition of individual coverage payment/reimbursement by employers
- **Guidance provided that employers cannot directly purchase individual policies or reimburse employees for the cost of individual policies through an "Employer Payment Plan" or a "Non-Integrated HRA"**

The IRS ACA Potluck Guidance (2015)

IRS Notice 2015-17; IRS Notice 2015-87

- Additional guidance reiterating the IRS prohibition of Employer Payment Plans and Non-Integrated HRAs
- Confirmed that even taxable reimbursements are prohibited, and that integration rules apply to employees, spouses and dependents

Penalties

IRC §4980D

- Employers offering an Employer Payment Plan or Non-Integrated HRA for employer reimbursement of individual policies violates the ACA market reform rules
- **Penalty is $100/day/employee excise taxes—resulting in potential penalties of $36,500 per employee per year**

ACA HRA Integration:
How to Meet the Required “Integrated HRA” Standard

The HRA Integration Rules

MV Integration Requirements
(Applicable to Specialty HRAs)

1. Employer offers major medical that provides minimum value (MV) to the employee
2. Employee covered by HRA is also enrolled in a group major medical plan that provides MV—whether through that employer or a spouse/DP/parent
3. HRA is available only to employees enrolled in a group major medical plan that provides MV—whether through that employer or a spouse/DP/parent
4. Employee is permitted to permanently opt-out of HRA at least annually and upon termination

Non-MV Integration Requirements

1. Employer offers major medical to the employee
2. Employee covered by the HRA is also enrolled in group major medical—whether through that employer or a spouse/DP/parent
3. HRA is available only to employees enrolled in a group major medical plan—whether through that employer or a spouse/DP/parent
4. HRA reimburses only cost-sharing amounts under the major medical and/or non-essential health benefits
5. Employee is permitted to permanently opt-out of HRA at least annually and upon termination

ACA HRA Integration:
How to Meet the Required “Integrated HRA” Standard

Summary of the ACA HRA Integration Rules

Non-Integrated HRA Prohibition

- Employers offering an HRA have to meet the “integration” requirements stemming from the Friday the 13th Guidance
- Those rules generally require that the employee be enrolled in an employer-sponsored major medical group health plan that provides minimum value to be eligible for reimbursement
- Most important piece is that HRAs cannot not be integrated with individual market coverage
- *Note: Indivdiual Coverage HRAs (ICHRAs) meeting several conditions are an exception to this rule*

Why Prohibited?

Non-integrated HRAs cannot satisfy the ACA market reform requirements for group health plans:

1. Does not comply with the ACA prohibition of annual limits on the dollar amount of essential health benefits; and
2. Does not satisfy the ACA requirement to provide certain preventive services without imposing any cost-sharing requirements for the services

- Potential Penalties: $100/day/employee excise tax under §4980D ($36,500/employee/year!)

Infertility HRAs: Common Expenses

Many Infertility Programs are Designed to Include Both Medical and Non-Medical Expenses

Common Medical Expenses Reimbursed by HRA on Tax-Free Basis

- In-vitro fertilization (IVF)
- Temporary sperm/egg freezing (informal IRS guidance suggests the cryopreservation must be limited to one year)
- Egg or sperm donor expenses for the employee or spouse to conceive
- Intrauterine insemination (IUI)
- Gamete intrafallopian transfer (GIFT)
- Zygote intrafallopian transfer (ZIFT)
- Embryo transfer
- Hysterosalpingogram
- Hysterectomy
- Intracytoplasmic sperm injection (ICSI)
- Laparoscopy
- Ovarian stimulation
- Semen analysis
- Testicular sperm aspiration/extraction
- Transvaginal ultrasound
- Operations to reverse a prior surgery that prevented the employee or spouse from having children

Common Non-Medical Expenses Reimbursed Outside HRA on Taxable Basis

- Surrogacy
- Non-temporary sperm/egg freezing (generally cryopreservation beyond one year)
- Egg or sperm donor expenses where neither the donor nor the carrier is the employee or spouse
- Same-sex couples with IUI, IVF, or other similar expenses but no medical diagnosis of infertility

Addressing Non-Medical Expenses

- An HRA can only reimburse §213(d) medical expenses
- Non-medical expenses must be a) reimbursed outside the HRA, and b) on a taxable basis to the employee
- Although these expenses cannot be reimbursed tax-free by an HRA, many employers still provide reimbursement for these non-medical expenses on a taxable basis through a broadly-defined infertility program
- Employers often present this as one integrated arrangement, but keep in mind the technical distinction here for non-medical reimbursements

Infertility HRAs: Common Expenses

The Sentence Heard 'Round the World?

IRS Private Letter Ruling (PLR) 202114001:
https://www.irs.gov/pub/irs-wd/202114001.pdf

> Only costs and fees directly attributable to medical care for diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body of the taxpayer, the taxpayer's spouse, or taxpayer's dependent qualify as eligible medical expenses. Expenses involving egg donation, IVF procedures, and gestational surrogacy incurred for third parties are not incurred for treatment of disease nor are they for the purpose of affecting any structure or function of taxpayers' bodies. As such, payments related to the following products and services are not deductible under I.R.C.§ 213: egg retrieval, IVF medical costs, childbirth costs and fees for the surrogate, surrogate medical insurance related to the pregnancy, legal and agency fees for the surrogacy, and other medical costs and fees arising from the surrogacy. In contrast, however, there are a comparatively smaller number of medical costs or fees paid for medical care directly attributable to taxpayers, examples in this case being sperm donation and sperm freezing, that are deductible medical expenses under I.R.C.§ 213, subject to the adjusted gross income limitation of the section.

Implications?

- IRS PLRs may not be relied on as precedent by other taxpayers or IRS personnel
- One sentence in a much longer PLR addressing much more significant surrogacy expenses
- However, some view as the IRS's directive to treat all infertility-related expenses that affect the body of the taxpayer (or in this case, the employee/spouse) as a §213(d) medical expense that can be reimbursed on a tax-free basis through the infertility HRA

What *Could* Be a §213(d) Expense if Broadly Viewed:

- Egg retrieval and IVF costs for same-sex female couple where are applied to employee/spouse
- Elective long-term egg freezing (with no infertility or medical necessity) from employee/spouse

Recommendation:

- Be cautious about reading too much into this PLR
- May be a one-sentence afterthought for smaller costs
- Not likely the IRS would change all previous fertility-related guidance for §213(d) expenses in this manner

Dobbs v. Jackson:

Employers Explore Options for Post-Roe Landscape

General Rule:
Abortion Becomes a State-by-State Issue

- U.S. Supreme Court's Dobbs decision held that the Constitution does not confer a right to abortion
- Overruled the existing framework under Roe and Casey that established nationwide right to obtain an abortion and forbid states from adopting any restriction on abortion access that imposed an "undue burden" on a woman's right to have an abortion prior to the point at which a fetus was thought to achieve "viability" (i.e., ability to so survive outside the womb)
- Since Dobbs, many states now ban abortion either entirely or at a certain point in the pregnancy

Option 1:
Address Abortion-Related Travel Through Health Plan

- In some cases, employers' major medical plans will provide abortion-related travel assistance coverage for employees or dependents who need to travel a significant distance to access abortion services
- For fully insured plans, employers will need to review options (if any) provided by insurance carrier to address
  - Generally, won't be an option for carrier to provide assistance if policy is sitused in a state that does not permit (or significantly restricts) abortions because of state legal barriers
- For self-insured plans, employers have more flexibility in plan design and specific benefit offerings
  - Still need to determine what options available in consultation with TPA and stop-loss provider

Option 2:
Address Abortion-Related Travel Through Specialty HRA

- Specialty HRAs are designed to cover a specific type of health expense that typically is not adequately covered by the major medical plan, while satisfying all the applicable group health plan laws that apply (ERISA, COBRA, HIPAA, ACA, etc.)
- HRAs are defined contribution, account-based plans that can solve for the group health plan compliance burdens associated with covering these additional employee medical expenses
- Full details: Compliance Considerations for Employer Reimbursement of Abortion-Related Expenses

Abortion-Related HRAs: Common Expenses

Many Employers Have Added Abortion Procedure and Travel HRAs for After the Dobbs Decision

Common Medical Expenses Reimbursed by HRA on Tax-Free Basis

- Legal abortion procedure costs
- Transportation:
  - To a new region or within the region
  - Must be primarily for, and essential to, medical care
  - Bus, taxi, train, airplane, rental car, Uber/Lyft used to go to and from the point of medical treatment
  - If using own car, IRS sets a mileage rate cap for reimbursement
- Lodging:
  - Up to $50/night limit
  - Up to $100/night if traveling with another person
  - Must be primarily for, and essential to, medical care
  - Medical care must be provided by a doctor in a licensed hospital or a medical facility related to, or equivalent of, a licensed hospital
  - Cannot be any significant element of pleasure/vacation/recreation
- Meals:
  - Included if provided at hospital or similar medical institution where individual is receiving medical care

Common Non-Medical Expenses Reimbursed Outside HRA on Taxable Basis

- Lodging expenses in excess of $50/individual/night
- Mileage reimbursement for car usage in excess of IRS milage rate cap
- Relocation expenses (no longer excludible from income after TCJA)
- Any other form of compensation provided to employees to assist in the abortion procedure/travel process that does not qualify as medical

Addressing Non-Medical Expenses

- An HRA can only reimburse §213(d) medical expenses
- Non-medical expenses must be a) reimbursed outside the HRA, and b) on a taxable basis to the employee
- Although these expenses cannot be reimbursed tax-free by an HRA, employers may still provide reimbursement for these non-medical expenses on a taxable basis through a broadly-defined abortion assistance program
- Employers may present this as one integrated arrangement, but keep in mind the technical distinction here for non-medical reimbursements

Preserving HSA Eligibility: Post-Deductible HRAs

HRAs Will Generally Block HSA Eligibility

- HRAs that are not specially designed as HSA-compatible are disqualifying coverage for any individual covered by a High Deductible Health Plan (HDHP)

Post-Deductible HRAs Are Not Disqualifying Coverage

- To avoid the HRA blocking employee's HSA eligibility, the HRA needs to be structured as post-deductible
- This requires that the HRA not permit any reimbursements (i.e., not pay any benefits) until the employee has reached the statutory minimum deductible (2024: $1,600 individual/$3,200 family) in expenses covered by the HDHP

Example	Result
• Mookie's employer offers a specialty HRA for infertility services—he is covered under the family HDHP • The HDHP does not cover any infertility expenses	• If Mookie is eligible for reimbursement under the infertility HRA, he's blocked from being HSA eligible • The employer has two ways of avoiding this issue: 1. Exclude employees covered by the HDHP from eligibility under the HRA; or 2. Make the HRA post-deductible for anyone covered by the HDHP • #2 requires that Mookie incur at least $1,600 or $3,200 in expenses covered by the HDHP before the HRA can pay

COBRA for HRAs

Five Main Concerns for Employers in Addressing this Tricky Issue

1	Determining the HRA Premium
2	Determining the HRA Balance During COBRA
3	Determining Which Employees Have COBRA Rights Under the HRA
4	Determining the HRA COBRA Maximum Coverage Period
5	Determining Who Would Elect COBRA for a HRA

COBRA for HRAs

Reminder: All HRAs are Subject to COBRA (Not Optional)

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Determining the HRA Premium

- Upon experiencing a qualifying event, HRA participants must receive a COBRA election notice that includes the option to elect COBRA under the HRA—but at what rate?
- This is the most difficult aspect of applying the COBRA rules to an HRA
- The limited IRS guidance in this area states that the standard rules apply that permit the employer to charge up to 102% of a reasonable estimate of the cost for providing the HRA to the participant
  - Employers generally are comfortable setting a reasonable estimate at 60% to 80% of the amount made annually available under the HRA
  - Based on the general rule of thumb that participants tend to take reimbursement of roughly 60%-80% of the full HRA balance made available each year
  - For example, employers might set the COBRA premium for an HRA with a $10,000 annual limit at 75% of that amount plus the 2% administrative fee ($637.50/month)
  - Note that the COBRA rate is not tied to the employee's balance remaining in the HRA at the time of the qualifying event—all COBRA qualified beneficiaries will have the same premium rate set at the beginning of the plan year

COBRA for HRAs

Reminder: All HRAs are Subject to COBRA (Not Optional)

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Determining the HRA Balance During COBRA

- COBRA qualified beneficiaries will continue to have access to the full amount made available under the HRA, reduced by all claims reimbursed while active and through COBRA
- Most HRAs are designed with an annual limit, which must continue to be available through COBRA
  - The COBRA qualified beneficiary is entitled to the full new annual limit each year for the duration of the COBRA maximum coverage period in the same manner as an active employee

COBRA for HRAs

Reminder: All HRAs are Subject to COBRA (Not Optional)

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Determining Which Employees Have COBRA Rights Under the HRA

- Only those employees participating in the HRA have COBRA rights to continue coverage
- Employers take different approaches to determine who is a participant in the HRA upon experiencing a COBRA triggering event (e.g., termination of employment)
  - *Default Approach:* All employees eligible for the HRA (and who have not affirmatively opted out of HRA coverage) are participants who have COBRA rights upon a triggering event
  - *Alternative Approach:* Employer requires employees to "enroll" in the HRA to determine whether they are participants
    - Enrollment is a nebulous concept for an HRA because (by definition) it has no employee contributions—but it can serve a purpose for COBRA and other administrative ends
  - *Aggressive Approach:* Treat only those employees who received reimbursement from the HRA as a participant for determining whether COBRA rights apply
    - Not a technically correct approach under COBRA rules because employees are covered by a group health plan regardless of whether they submit claims—but it does happen in practice

COBRA for HRAs

Reminder: All HRAs are Subject to COBRA (Not Optional)

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Determining the HRA COBRA Maximum Coverage Period

- Employees who experience a qualifying event are entitled to the full maximum coverage period through COBRA
- The most common qualifying events (loss of coverage caused by termination of employment or reduction of hours) provide for an 18-month maximum coverage period
  - Note that the special health FSA rule that shortens the COBRA maximum coverage period to only the remainder of the current plan year does **not** apply to HRAs
  - Note that state mini-COBRA laws also do **not** apply to HRAs because the HRA is a self-insured group health plan

COBRA for HRAs

Reminder: All HRAs are Subject to COBRA (Not Optional)

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Determining Who Would Elect COBRA for a HRA

- Very rare for employees to elect COBRA for an HRA
- In vast majority of situations, the employee will have no interest in paying the required COBRA premium on an after-tax basis to maintain the HRA continuation coverage
- In rare situations where the employee experiences a qualifying event and expects to immediately incur expenses covered by the HRA, COBRA may make sense
  - For example, an employee who terminates employment and expects to incur IVF expenses in the upcoming months
  - In that situation, it could make sense for the employee to continue coverage under an infertility HRA through COBRA to pay only a few months of COBRA premiums for potentially a far larger sum in IVF expense reimbursement
  - These situations are not likely to occur very often

§105(h) Nondiscrimination Rules for HRAs

HRAs are self-insured group health plans, and therefore they are subject to the §105(h) nondiscrimination rules. There are three main components to the rules:

Eligibility Test	• Can exclude or provide different eligibility terms for categories of employees only if the classification is “reasonable and nondiscriminatory” • Definition of “reasonable and nondiscriminatory” specifically refers to distinctions based on the nature of compensation, such as hourly vs. salaried, and geographic location • Generally fine for employers to provide different specialty HRA eligibility terms to employees based on hourly vs. salaried or employee groups in different regions
Benefits Test	• Requires that all benefits provided to eligible Highly Compensated Individuals (HCIs) under the plan also be available to all eligible non-HCIs • Creating different classes of benefits for eligible employees can be a problem because it may result in non-HCIs in the lower tier class not receiving the richer benefits available to HCIs in the higher class • §105(h) rules do allow employers to disaggregate into separate plans for testing purposes by specifying in the HRA plan document that the different arrangements are treated as separate plans
Operational Discrimination	• Umbrella provision preventing self-insured group health plans from discriminating against non-HCIs in operation—a facts and circumstances test based on each plan’s specific arrangement • Unlikely to become an issue in specialty HRA plan design because plan is not considered discriminatory merely because HCIs participating in the plan utilize benefits to a greater extent than non-HCIs • Main practice to avoid is employer selectively establishing, amending, or terminating the HRA in a manner designed to benefit HCIs (e.g., to specifically cover only certain HCIs expenses)

§105(h) Nondiscrimination Rules for HRAs

HRAs are self-insured group health plans, and therefore they are subject to the §105(h) nondiscrimination rules. Additional aspects of the §105(h) rules to be aware of:

HCI Definition	• The §105(h) rules define highly compensated individuals (HCIs) differently than the §125 highly compensated participant (HCP) and §129 highly compensated employee (HCE) definitions
	• For purposes of §105(h), an HCI is:
	  • One of the top five highest-paid officers;
	  • A shareholder who owns more than 10% of the value of the employer's stock; or
	  • Among the highest-paid top 25% of all employees in the current plan year

Separate Plans Provision	• Template HRA plan document provision to disaggregate the plan for §105(h) purposes: • *Pursuant to the "Multiple plans" provisions set forth in Treas. Reg. §1.105-11(c)(4), each coverage level, each group of Employees covered by the Plan, and each class of benefits provided under the Plan constitute a separate "plan" for purposes of the Internal Revenue Code §105(h) nondiscrimination requirements and any other applicable law.*

Failing the §105(h) Rules	• If the IRS were to audit a specialty HRA and find its arrangement to be discriminatory under §105(h):
	  • All HCIs would be taxed on all or a portion of the benefits they received under the plan, referred to as the "excess reimbursement"
	  • This could be a significant tax liability depending on the amount and cost of services received by the HCIs

PCORI Fee for HRAs

The PCORI Fee Applies to HRAs—But Special Rules Limit Cost

- HRAs are self-insured health plans subject to the PCORI fee
- Exception: No PCORI fee required for the HRA if it is paired with a self-insured major medical plan that has the same plan year as the HRA (to avoid paying the PCORI fee for both the self-insured medical plan and the HRA)
- No exception available where the HRA is paired with fully insured major medical coverage
  - Insurance carrier is responsible for paying the PCORI fee for the fully insured plan, employer responsible for paying for the HRA
  - However, the PCORI rules do provide that the employer is required to count only one covered life per employee for HRAs
  - Means that the employer does not have to pay the PCORI fee for any covered dependents under the HRA

PCORI Fees	July 31, 2023 Form 720 PCORI Filing	July 31, 2024 Form 720 PCORI Filing
Plan Year Ends January 1–September 30	Applicable Rate: • $2.79 per covered individual	Applicable Rate: • $3.00 per covered individual
Plan Year Ends October 1–December 31 (Including Calendar Plan Years)	Applicable Rate: • $3.00 per covered individual	Applicable Rate: • $3.22 per covered individual

PCORI Fees: Plans Subject to PCORI

PCORI Fee Applies to Major Medical Plans and HRAs

- **Major Medical Plans**
  PCORI fee does not apply to dental and vision coverage or health FSAs that qualify as excepted benefits (virtually all dental/vision/health FSAs qualify)
  - EAPs and wellness programs also not subject to PCORI as long as the plans do not “provide significant benefits in the nature of medical care or treatment”
  - Where medical plan is fully insured (and employer does not sponsor an HRA),the insurance carrier pays the PCORI fee—no action item for the employer!
  - Where medical plan is self-insured (including level-funded) or employer offers an HRA, employer must pay the PCORI fee via Form 720 by July 31 annually
- **Health Reimbursement Arrangements (HRAs)**
  - HRAs are a self-insured health plan subject to the PCORI fee
  - Includes HRAs designed to cover cost-sharing under the major medical plan
  - Includes specialty HRAs such as those designed to cover infertility, abortion-related travel assistance, gender dysphoria, mental health, etc.
  - Two Special HRA PCORI Rules:
  1. *Self-Insured Medical*: If employer’s medical plan is self-insured and has the same plan year as the HRA, PCORI fee not required for HRA (only medical)
  2. *Fully Insured Medical*: Employer must pay PCORI fee for HRA, but only required to pay for covered employee (not for covered dependents)

Who Pays the PCORI Fee?

Fully Insured Medical Plan:

- Health insurance carrier pays
- Fee is built into premium cost

Self-Insured Medical Plan:

- Employer pays via Form 720
- Includes level-funded plans

Fully Insured Medical Plan with an HRA:

- Carrier pays for medical plan
- Employer pays for HRA

Self-Insured Medical Plan with an HRA:

- Employer generally pays only for medical plan (not HRA)

PCORI Fees: Plans Subject to PCORI

PCORI Fee Applies to Major Medical Plans and HRAs

- **Page 1**
  - The employer will complete their name and address and employer identification number at the top of the form.
  - Quarter ending will be June 30, and the current year in which you are filing.
  - Final return will be checked if the employer is going out of business, or no longer has a self-insured medical plan or HRA.
  - Address change will be checked if the employer has changed their address since the last filing.
- **Page 2**
  - Skip to Part II, line 133 – Applicable self-insured health plans and choose the plan year ending. Line (c) is for plan years ending before October 1 (non-calendar year plans) and line (d) is for plan years ending on or after October 1 (generally calendar year plans)
  - Enter the number of lives on either line (c) or (d) using one of the methods outlined in the IRS PCORI fee homepage. You may enter the number of lives on both lines if you are filing for a full 12-month plan year and a short plan year.
  - Multiply the number of lives in lines (c) or (d) by the rate in column b and enter the result in column (c) Fee
  - Bring the total of lines (c) and (d) in the Fee column over to the tax column
  - Bring the same total down to line 2 Total
- **Page 3**
  - Line 3: bring the same total from Line 2 forward to this line
  - Line 10: bring the amount from line 3 down to line 10
  - Sign and date the form and return with payment.

Additional Notes

- PCORI fee is always paid on the second quarter Form 720, regardless of plan year
- Penalties for failure to timely file Form 720 can range from 5% to 25% of amount due
- Penalties for failure to timely pay PCORI fee can range from 0.5% to 25% of amount due
- Any person authorized by the company can sign the form
- Payment can be made by check or electronically via IRS EFTPS
- Form 720 is quarterly, but PCORI fee is only filed in Q2!

Excepted Benefit HRA (EBHRA): Alternative Vehicle for Other Health Expenses

EBHRAs Became Available in 2020: Four Conditions to Avoid ACA Market Reform Provisions as an “Excepted Benefit” and Avoid ACA Integration Rules

1

EBHRA is Not Integral to Part of the Plan (Eligibility for Traditional GHP)

- Only Employees eligible for the traditional GHP can be eligible for the EBHRA
- Employees do not have to enroll in the traditional GHP (unlike ACA integration rule for non-excepted HRAs)

2

EBHRA Must Provide Benefits that Are Limited in Amount

- Amounts made newly available for a plan year cannot exceed $2,100 (plan years beginning in 2024)
- Limit is indexed annually for inflation and released in same IRS document as the HSA limits
- The relatively low cap is a major barrier on usefulness of EBHRAs, which are not commonly offered in practice

3

EBHRA Cannot Reimburse Premiums (Individual or Group)

- The only permitted premiums would be excepted benefits like dental/vision coverage, COBRA premiums, and in some cases short-term limited duration insurance (STLDI) premiums

4

EBHRA Must Be Available Under Same Terms to Similarly Situated All Individuals

- The EBHRA must be available to all similarly situated individuals on the same terms regardless of any health factor

02

Lifestyle Spending Accounts

Taxable “Wellness” Funds

What is a Lifestyle Spending Account?

Lifestyle Spending Accounts (LSAs) are an increasingly popular employer-funded arrangement for employers to reimburse common and beneficial expenses incurred by employees during ordinary life.

- *Designs vary considerably because of their flexibility, but a typical approach is to offer roughly $500-$2,000 annually for physical, emotional, and financial wellness costs. Unused amounts may forfeit or carry over.*

Physical Wellness Examples:	Emotional Wellness Examples:	Financial Wellness Examples:
• Athletic equipment and accessories • Exercise equipment • Gym, health club, spa, and fitness studio memberships • Recreational sport expenses such as rock climbing, martial arts, tennis, race or league entry fees • Fitness class expenses such as yoga, pilates, cycling • Sport lesson expenses such as golf, swimming, tennis, dance • Personal trainers, fitness trackers • Nutritional supplements • Ski, snowboard, golf, passes	• Meditation classes • Non-medical counseling services such as marital counseling, life coaching, parental skill counseling, executive coaching • Retreats such as leadership and spiritual retreats • Personal development classes such as art and cooking • Pet care such as walkers, day care, grooming • Camping such as equipment and fees • Park passes • Licenses such as fishing, hunting	• Home purchase costs such as down payment, closing costs • Financial advisor and planning services • Financial seminars and classes • Estate planning costs • Credit counseling • Vacation funding • Charitable donations

General Rule: Compensation Taxable (Unless Exclusion Applies)

LSAs are not designed to take advantage of any Code section that would permit employers to exclude the benefit from employees' income. LSAs are specifically designed to avoid tax-advantaged limitations.

Fringe Benefits Taxable Where No Exclusion Applies	**Taxation of Fringe Benefits** IRS Guidance
General Rule: • Gross income means all income from whatever source derived ("income realized in any form") • The fair market value of any fringe benefit offered to employees must be included in the employee's taxable income unless a specific exclusion applies • IRC §61 specifically refers to "compensation for services, including fringe benefits, and similar items" • LSAs are designed to include benefits for which no exclusion applies to avoid the complications, limitations, and compliance burdens associated with tax-advantaged accounts • Means that LSAs are a taxable fringe benefit	**Treas. Reg. §1.61-21(a)(1):** *(1) In general. Section 61(a)(1) provides that, except as otherwise provided in subtitle A of the Internal Revenue Code of 1986, gross income includes compensation for services, including fees, commissions, fringe benefits, and similar items.* **IRS Publication 15-B** *Are Fringe Benefits Taxable?* *Any fringe benefit you provide is taxable and must be included in the recipient's pay unless the law specifically excludes it.* **IRS Publication 5137** *Fringe benefits that do not meet any statutory requirements for exclusion are fully taxable. Although there are special rules and elections for certain benefits, in general, employers report taxable fringe benefits as wages on Form W-2 for the year in which the employee received them.*

LSA Taxation: Competing Theories on Proper Approach

LSAs are Not Tax-Advantaged!
They are purposefully designed not to be a tax-advantaged account to avoid the strict limitations associated with those arrangements. Employees do not enjoy an exclusion from income with respect to LSA benefits as they would for other account-based offerings such as FSAs, HSAs, HRAs, commuter benefits, educational assistance, etc.

Common Approach to Taxation
Benefits Taxable Upon Reimbursement

Most employers take the position that LSA benefits are taxable to employees upon reimbursement

- Under this standard approach, the employer includes in the employee's gross income (and subject to withholding and payroll taxes) the amount of each LSA reimbursement
- Any amount made available to the employee but not reimbursed is not included in the employee's taxable income
- Excess amounts may be carried over or forfeited per plan design
- Although employers almost always follow this approach in practice, it's not clear the IRS agrees with this industry standard

Constructive Receipt Approach to Taxation
Value of Amount Made Available is Taxable

There is an argument that employers should include in employees' taxable income the value of the LSA amount made available to employees for reimbursement regardless of the amount reimbursed to the employee

- This approach is based on the doctrine of "constructive receipt" (Treas. Reg. §1.451-2(a))
- Basic principle is that you cannot "turn your back on taxable income" to escape income taxes
- Means employees are treated as in constructive receipt of the value of the full LSA amount made available and it is taxable income regardless of utilization

Key Areas for LSAs to Avoid

LSAs are Designed to Avoid Compliance Issues Associated with Tax-Advantaged Accounts

1
Medical Benefits

2
Other Tax-Advantaged Benefits

Medical Benefits

- Reimbursement of §213(d) health expenses creates a group health plan
- That would trigger the full array of group health plan laws (ERISA, COBRA, HIPAA, ACA, HSA eligibility, §105(h), etc.)
- Employers therefore should avoid covering any medical expense under the LSA

Other Tax-Advantaged Benefits

- It generally does not make sense to include in an LSA any expense that could otherwise be provided on a tax-free basis outside the LSA
- Inclusion of a potentially tax-advantaged benefit in the LSA would make the expense taxable

Key Areas for LSAs to Avoid: Medical Benefits

Avoid Inadvertently Creating a Group Health Plan

Carefully Monitor the Benefits to Avoid §213(d) Expenses

- LSAs are intended to be a taxable, non-group health plan benefit
- Failure to exclude such medical expenses would cause onerous group health plan laws such as ERISA, COBRA, HIPAA, ACA, etc. to apply
- Avoid expenses such as smoking cessation, mental health therapy, acupuncture, and chiropractic treatment that are §213(d) expenses
- Such expenses could be included in a separate medical wellness program arrangement designed to comply with applicable group health plan laws
- Look to IRS Publication 502 for a useful summary of §213(d) expenses

"Dual Purpose" Expenses Can Be Included

- Dual purposes expenses are generally non-medical but can be considered medical where incurred upon the advice of a medical practitioner to treat a specified medical condition
- These are expenses that a health FSA will reimburse only if the employee provides a letter of medical necessity from a treating physician
- Examples include gym membership, massage, nutritionist expenses, exercise equipment, health club, smartwatch, fitness tracker, personal trainer
- No issue with an LSA including dual purpose expenses that are overwhelmingly non-medical as long as the LSA does not condition the benefit on the employee's medical status (no Rx/letter of medical necessity required)

Common Expenses To Avoid

- Smoking cessation programs and products
- Acupuncture
- Mental health therapy
- Chiropractic treatment
- Abortion
- IVF and other infertility treatments
- Treatment for alcoholism and drug addiction
- Laser eye surgery
- Hearing aids
- Medical travel costs (including abortion-related travel)

Areas for LSAs to Avoid: Other Tax-Advantaged Benefits

If it Ain't Broke…Don't "Fix" it by Adding it to an LSA

LSA Causes Loss of Tax-Advantaged Status

- Employers have broad flexibility to include virtually any non-medical expense as reimbursable by the LSA
- However, the LSA is intended not to be tax-advantaged to avoid all the restrictions placed on tax-free arrangements
- It generally does not make sense for employers to include in an LSA any expense that could otherwise be provided on a tax-free basis by the employer outside the LSA
- Inclusion in the LSA has the effect of providing a taxable benefit that could have otherwise been provided as non-taxable

Examples of Potentially Tax-Advantaged Expenses to Exclude

- Dependent care expenses (§125/§129 dependent care FSA)
- Student loan reimbursement (§127 educational assistance)
- Tuition assistance (§127 or §132 educational assistance)
- Commuter benefits (§132 transit pass/vanpool, parking)
- Identity theft protection (IRS guidance excluding from income)
- Adoption expenses (§139 adoption assistance plan)

Is There an Argument to Include These Expenses?

- Some employers have a strong desire to make the LSA a one-stop catchall benefit for all expenses, even if it causes the benefits to be taxable
- While including medical expenses is clearly problematic because of group health plan laws, these non-medical expenses don't have that issue
- Employers could in theory gross up employees for the tax liability and provide essentially the same benefit, but that is far more costly and unnecessary

LSA Summary: Advantages and Disadvantages

Advantages of the LSA: Simplicity and Flexibility

Fewer Rules:

- Very few compliance issues associated with LSAs because they are not tax-advantaged or subject to GHP laws

Flexibility:

- Employers can include virtually any non-medical expense as eligible for reimbursement

No Limits:

- There are no limits on the amount of employer funds made available for reimbursement

No Formal Documentation:

- Employers can use simple communications to describe LSAs

Low Cost:

- Most FSA TPAs will administer LSAs for a relatively low fee

Corporate Culture:

- Can be customized to fit specific wellness and culture goals

Quick Win:

- Novelty of LSAs can create employee excitement/morale boost

Disadvantages of the LSA: Taxes and Avoiding Certain Expenses

Taxable:

- LSAs are (purposefully) not tax-advantaged, and therefore employees will be taxed on the LSA unlike other account-based arrangements with which employees are familiar

Competing Taxation Theories:

- Employers face different approaches for how to tax LSAs, with no guidance confirming the standard taxable benefit approach

Excluding Medical Expenses:

- Employers need to exclude §213(d) medical expenses from the LSA to avoid inadvertently triggering vast array of GHP laws

Excluding Other Tax-Advantaged Expenses:

- Employers should exclude other potentially tax-advantaged benefits to utilize the exemption from income in a separate vehicle designed to take advantage of tax-free opportunity

Exclusively Employer-Funded:

- There is no point to having an employee funded LSA because there is no tax advantage, so LSAs are exclusively paid for by the employer and therefore add cost to their budget

03

Commuter Benefits

Transit and Parking

Commuter Benefits:
Three Forms of Qualified Transportation Fringe (§132(f))

1

Transit Passes

2024 Limit: $315/month (combined with vanpooling)

- Defined: Any pass, token, farecard, voucher, or similar item for mass transit
- Employee contributions: Pre-tax up to $315/month limit (combined with employer contributions)
- Employer contributions: Tax-free up to $315/month limit (combined with employee contributions)
- Excess contributions: Permitted as taxable income to employee

2

Commuter Highway Vehicle (Vanpooling)

2024 Limit: $315/month (combined with transit passes)

- Requirement #1—Capacity: Vehicle with seating capacity of at least six adults (excluding driver)
- Requirement #2—The 80/50 Rule : At least 80% of vehicle's mileage is reasonably expected to be for commuting employees, where at least 50% of the adult seating capacity (excluding driver) is filled with employees
- Exception: The 80/50 Rule does not apply to ridesharing vanpools, such as UberPool or Lyft Line

3

Qualified Parking

2024 Limit: $315/month

- Option #1: Parking provided on or near the employer's business premises
- Option #2: Parking provided at a location from which the employee commutes to work (e.g., at mass transit)
- **Not Combined:** Can contribute $315/month for parking on top of $315/month for transit pass/vanpool
- Not for Residences: Parking on or near the employee's residence is not qualified (even for a home office)

Commuter Benefits: Employer Contributions

General Tax-Advantaged Status of Qualified Transportation Plans Under IRC §132(f)

Combined Employer/Employee Monthly Contribution Limit

- Section 132(f) provides a tax-advantaged limit of $315 per month (2024) that may be contributed to a transit pass/vanpooling and/or parking commuter benefit program
  - Monthly limit is adjusted annually for inflation
- Both employer and employee contributions count toward the $315 monthly limit
- The availability of employee pre-tax contributions will be reduced by the amount of tax-free employer contributions
  - *Example:* Employer provides a mass transit/vanpooling or parking subsidy of $100/month to the commuter benefit account
  - *Result:* Employee can contribute on a pre-tax basis up to $215/month for each benefit
  - *After-Tax Option:* Contributions to a commuter benefit in excess of $315/month are permitted on an after-tax basis

IRS Prohibition of Direct Employer Reimbursement for Tax-Free Transit Expenses

Generally Must Use Terminal-Restricted Debit Cards

- Longstanding rule that cash reimbursement of transit passes is permitted under §132 as a non-taxable qualified transportation plan only if a voucher (or other similar item which may be exchanged only for a transit pass) is not “readily available” in that area
  - Standard became extremely complex over time as IRS issued numerous ruling attempting to define “readily available”
- IRS determined that as of 2016, vouchers (including terminal-restricted debit cards) have become readily available throughout U.S.
- As a result, cash reimbursement is not permitted anymore where terminal-restricted debit cards are readily available (most places)
  - Means that employers must generally provide §132 non-taxable mass transit benefits through an FSA-style debit card (or commuter checks)
  - If IRS were to discover cash reimbursement approach, it could recharacterize all reimbursements as taxable income to employees

Commuter Benefits: Termination of Employment

Required Forfeiture of Unused Contributions

No Expenses After Termination of Employment

- Participation in commuter benefit must end no later than the date the employee terminates employment
- Employees cannot incur expenses that are reimbursable by the commuter plan on any date post-termination
    - For example, allowing a grace period for employees to incur expenses through the end of the month in which the employee terminates would violate §132(f) and potentially cause the program to be disqualified, resulting in all elections becoming taxable to all employees

Run-Out Period

- Generally not a problem for the commuter plan to permit a run-out period to submit claims incurred pre-termination
    - Transit expenses generally cannot be reimbursed and therefore there should be no claims outstanding at termination, debit card should be deactivated

Required Forfeitures

- Employees cannot be cashed out or refunded (even on a taxable basis) for any unused commuter balance
- Terminated employees cannot use the commuter funds, and employers cannot provide a cash refund to terminated employees
- Result is that employees must forfeit any remaining commuter balance after termination (and any applicable run-out period)
- Commuter benefits are not subject to ERISA, and are not governed by the Section 125 cafeteria plan rules for FSA forfeitures
- Section 132(f) rules do not impose any limitations on the employer's use of forfeitures (other than prohibition of cash out or refund)
    - Employer may retain commuter account forfeitures, allocate them evenly to the accounts of other commuter participants, use the amounts for plan administrative expense, or use them for any other purpose

Commuter Benefits: Template Employee Communication

Sample Language Upon Termination of Employment—Required Forfeiture of Unused Commuter Benefit Contributions

The Internal Revenue Code governs commuter benefit plans. Pursuant to IRS regulations, employees who cease to participate in the plan (for example, because of termination of employment) must forfeit any contribution amounts remaining in their commuter benefit account.

The Company cannot make any exceptions to these forfeiture requirements. Commuter contributions are not refundable (even on a taxable basis) under any circumstances, including upon termination of employment. (Treas. Reg. §1.132-9, Q/A-14(d)).

Failure to follow the terms of the Internal Revenue Code and applicable IRS regulations could cause the entire commuter benefit plan to lose its tax-advantaged status. If this were to occur, all of the Company's employees participating in the commuter benefit plan would be taxed on their commuter benefit elections.

There are no tax reporting or other related tax consequences associated with the forfeiture because your contributions to the commuter account were made on a pre-tax basis.

Commuter Benefits: Recent IRS Guidance

1

Current Employees with a Commuter Account Balance but No Ongoing Expenses

Recent Guidance: IRS Information Letter 2020-0031 (https://www.irs.gov/pub/irs-wd/20-0031.pdf)

- §132 rules are clear that employees cannot subsequently receive the compensation that was contributed to the commuter account in cash or any form other than by payment of a qualifying commuter expense under plan
- Employees can decrease or revoke a commuter election prospectively to discontinue further contributions
- IRS reiterated in 2020-0031 that although ongoing expenses may have dried up (e.g., because of Covid), amounts already contributed remain nonrefundable and available only for qualifying commuter expenses

2

Current Employees with Transit Balance but Currently Only Have Parking Expenses

Recent Guidance: IRS Information Letter 2020-0024 (https://www.irs.gov/pub/irs-wd/20-0024.pdf)

- Covid has resulted in many employees using less mass transit/vanpooling and more driving to work
- IRS states in 2020-0024 that employers can permit employees to roll unused transit benefits to be used for the parking benefit as long as the maximum monthly amount ($315 in 2024) is not exceeded
- This option can also be offered in the reverse to roll unused parking benefits to the mass transit/vanpool option

3

Even Involuntarily Terminated Employees Must Forfeit Unused Balance

Recent Guidance: IRS Information Letter 2019-0002 (https://www.irs.gov/pub/irs-wd/19-0002.pdf)

- Only current employees can participate in the commuter account—no expenses reimbursable post-termination
- Cash outs and refunds are prohibited, even on a taxable basis, where participation ceases
- Unused amounts must be forfeited to the employer after any applicable run-out period
- IRS reiterates in 2019-0002 that these rules do not distinguish between involuntary and voluntary termination

Commuter Benefit Elections: May Be Changed Monthly

Unlike the strict Section 125 cafeteria plan irrevocable election rules, the Section 132(f) commuter rules permit employees to change their election every month, and for any reason.

Section 125 Cafeteria Plan: Irrevocable Elections—Permitted Election Change Events	**Section 132(f) Commuter Benefits:** Employees May Change Elections Monthly

Commuter Benefits are Not a Section 125 Qualified Benefit:

- Elections to contribute pre-tax to the commuter benefit plan are not governed by Section 125
- Section 125 rules govern employee pre-tax contributions for medical, dental, vision, health FSA, dependent care FSA, etc.

Cafeteria Plan Election Rules:

- The general rule under Section 125 is that elections must be:

1. Made prior to the period of coverage (e.g., open enrollment)
2. Irrevocable for the plan year unless the employee experiences a permitted election change event

Permitted Election Change Events:

- Events set forth in Treas. Reg. §1.125-4
    - E.g., marriage, divorce, birth, adoption, loss of coverage
    - See here for summary overview of the permitted events

One-Month Period of Coverage:

- Big difference between commuter benefit accounts and FSAs is that the §132(f) commuter period of coverage can be (and almost always is) limited to only one month
- Means that employees can change their commuter pre-tax contribution election for each month without the need to experience any form of life event or other qualification
    - No irrevocable election rule as with Section 125—employees are not “locked in” to their elections for the year

Prospective Election Changes Only:

- Only limitation is that the employee’s commuter election must be made before the next month’s period of coverage
    - Irrevocable for only that one-month period of coverage

Avoiding Forfeitures:

- Employees whose commutes change should modify their commuter election going forward to minimize risk of forfeitures

Overview of State and Local Commuter Mandates

State or City	Name of Law	Effective Date	Employers	Commuter Options	Reporting Requirements	Employer Penalties
San Francisco Bay Area	Air District Regulation 14, Rule 1	March 26, 2014	Employers with 50 or more employees within 9 Bay Area counties must provide a commuter benefits program to any employee who works 20 or more hours per week	• Pre-tax election • Employer provided subsidy • Employer provided transit • Alternate commuter benefit • Remote work	Employers must register on 511.org with their contact information and commuter benefit option; annual updates are required	Penalties for general violations ranging from $5,000-$25,000;
New York City	Commuter Benefits Law	January 1, 2016	Employers with 20 or more full-time non-union employees in New York City.	• Pre-tax election • Employer paid option	No reporting requirements; employers must keep records that demonstrate eligible employees offered pre-tax benefits	Penalties of $100-$250 for the first violation and additional penalties of $250 for every 30 days of non-compliance
Seattle	Commuter Benefits Ordinance	January 1, 2020	Employers of 20 or more employees worldwide on average in the prior calendar year, or in the first 90 calendar days an employer was in business must offer commuter benefits to employees who work on average 10 hours per week in Seattle.	• Pre-tax election	No reporting requirements; employers required to retain written records for 3 years	Penalties between $500 and $5,000
New Jersey	Senate Bill 1567	Effective March 1, 2019 but inoperative until March 1, 2020	Employers who employ 20 or more employees total are required to provide commuter benefits to all employees	• Pre-tax election	No reporting requirements	Penalties between $100 - $250 initially and additional penalties of $250 for every 30 days of non-compliance

Overview of State and Local Commuter Mandates

State or City	Name of Law	Effective Date	Employers	Commuter Options	Reporting Requirements	Employer Penalties
Philadelphia PA	Ordinance No. 220337	December 31, 2022	Employers with at least 50 employees in Philadelphia most provide employees working 30 or more hours per week for the past 12 months must provide one of several options	• Pre-tax election • Employer paid benefit • Any combination of the two	No reporting requirements currently	If not in compliance 30 days following a written warning, subject to fines for each day not in compliance.
San Francisco	Commuter Benefits Ordinance	January 2009	Employers with a San Francisco location and 20 or more employees nationwide; employers with 50 or more follow Bay Area Commuter Ordinance	• Pre-tax election • Employer paid benefit • Employer provided transportation	Complete the SF Commuter Benefit Compliance Reporting form	Fines between $100 - $800
Berkeley	City of Berkeley Commuter Benefit Program Ordinance	November 2010	10 or more employees who work an average of 10 hours per week in Berkeley; employers with 50 or more employees follow Bay Area Commuter Ordinance	• Pre-tax plan for transit, vanpool or bicycle • Transit subsidy equivalent to the value of an AC Transit local monthly pass • Employer provided shuttle service	No reporting requirements	Monetary fines and penalties
Richmond	Commuter Benefits Ordinance	December 2009	All registered businesses with 10 or more employees who work an average of 10 hours per week in Richmond; employers with 50 or more employees follow Bay Area Commuter Ordinance	• Pre-tax election • Employer paid benefit (transit pass or van pool reimbursement) • Employer provided transit • Alternative commuter benefit pre-approved by the City of Richmond	One time registration form	Penalties between $200-$600

Overview of State and Local Commuter Mandates

State or City	Name of Law	Effective Date	Employers	Commuter Options	Reporting Requirements	Employer Penalties
Washington DC	Commuter Benefits Program	January 1, 2016	Employers with at least 20 employees in DC must provide a commuter benefits program to employees who work at least 50% of their time in DC	• Pre-tax election • Employer paid benefit • Employer provided transit	No reporting requirements; employers must maintain records that notice was given and benefits were provided	Monetary fines, penalties and hearing costs
Washington DC	Transportation Benefits Equity Amendment Act of 2020	Later of January 15, 2023 or end of parking lease	DC employers with 20 or more employees who work in DC that offer free or subsidized leased parking benefits must adopt one of the several parking cash out options	• Offer a clean air transportation fringe benefit in the form of transportation in a commuter highway vehicle, transit pass or qualified bicycle commuter reimbursement in exchange for declining parking. Benefit offered must be equal or greater value than the parking benefit • Transportation demand management plan to reduce commutes by car by 10% annually until 25% or less of employees commute by car • Pay a clean air compliance fee of $100 per month for each DC employee offered a parking benefit	All covered employers must submit a report to the DDOT that includes • Total number of DC employees • Number of DC employees offered a parking benefit, • Number of employees using a parking benefit • Number of employees offered a clean air transportation fringe benefit, • Number of employees using the clean air transportation fringe benefit • Number of employees for whom paying $100 Clean Air Compliance Fee	The Mayor may impose civil fines or penalties as sanctions for a violation of subsection (a) or subsection (f) of this section, or any rule issued pursuant to section 303(b) pursuant to the Department of Consumer and Regulatory Affairs Civil Infractions Act of 1985, effective October 5, 1985 (D.C. Law 6-42; D.C. Official Code § 2-1801.01 et seq.) ("Civil Infractions Act"). Enforcement and adjudication of an infraction shall be pursuant to the Civil Infractions Act.
Illinois	Transportation Benefits Program Act (HB 2068	January 1, 2024	Employers with 50 or more employees in designated transit zones must provide pre-tax transit benefits to covered employees who average 35 hours work per week.	• Pre-tax election	No reporting requirements	No penalties currently specified

04

Educational Assistance

Including New Student Loan Repayment Assistance Option

Educational Assistance: Two Main Types of Programs

Employers have two main Code section approaches available for providing tax-free educational assistance. The §127 approach is more common than the §132 approach.

Section 127:
Qualified Educational Assistance Program

Basic Rule:

- Employers can exclude up to $5,250 annually for educational assistance provided to employees under §127
- Includes cost of books, equipment, fees, supplies, and tuition

Main Advantages:

- Educational expenses do not need to be work-related
- Can reimburse expenses exceeding $5,250 on a taxable basis
- Student loan repayment a qualifying expense through 2025

Main Disadvantages:

- Capped at $5,250 annual limit for tax-free reimbursement
- Requires a written plan document
- Must provide reasonable notification of the availability and the terms of the program to all eligible employees
- Subject to nondiscrimination rules to ensure the program does not discriminate in favor of HCEs as defined in §414(q)

Section 132(d):
Working Condition Fringe Educational Assistance

Basic Rule:

Educational assistance can be provided as a tax-free working condition fringe under §132 where it meets one of the following:

1. The education is required by the employer or by law for the employee to keep his or her present salary, status, or job; or
2. The education maintains or improves skills needed in the job

Main Advantages:

- No annual limit
- No written plan document required
- No nondiscrimination rules

Main Disadvantages:

- Must be work-related educational expenses (unlike §127)
- Cannot be needed to meet the minimum educational requirements of the employee's present trade or business
- Cannot be part of a program of study that will qualify the employee for a new trade or business

Qualified Educational Assistance Program (§127)

General Rules

- Tax-free assistance cannot exceed **$5,250 per calendar year** for all employers of the employee combined (excess amounts are taxable)
- Employer must have a written plan, with reasonable notice of availability and terms to all eligible employees
- Plan cannot offer other benefits or taxable compensation (e.g., cash) that can be selected instead of education
- Plan must not discriminate in favor of highly compensated employees ($150k+)

Educational Expenses

No Work-Related Requirement (Unlike §132)

- §127 qualified educational expenses:
  - Tuition, books, supplies, equipment necessary for class, and student loan repayment assistance (through 2025)
- Expenses that do not qualify:
  - Tools or supplies (other than textbooks) the employee is allowed to keep at the end of the course
  - Courses involving sports, games, or hobbies unless they have reasonable relationship to business or required as part of a degree program
  - Meals, lodging, or transportation

Examples

- Qualifying: Secretary takes an undergrad psychology class at local college; Janitor takes math class toward bachelor degree
  - Doesn't matter that the expenses are not job-related under §127 program (unlike §132 working condition fringe)
- Not Qualifying: Accountant takes courses toward a license as a soccer referee
  - Sports-related courses are not eligible unless they have a reasonable relationship to the employer's business or part of degree program

Qualified Educational Assistance Program (§127)

CARES Act Added Student Loan Repayment, CAA Extended Through 2025

The CARES Act expanded upon the existing §127 qualified educational assistance provisions to include student loan reimbursement in 2020. The CAA extended the optional employer tax-free offering through the end of 2025.

IRC §127 Permits Tax-Free Educational Assistance

- Allows employers to cover the cost of educational expenses for an employee tax-free
- Did not include student loan repayments prior to CARES Act
- Capped at $5,250 per calendar year

Tax-Free Student Loan Repayment Permitted Through 2025

- The CARES Act permitted employers to offer an educational assistance program to reimburse student loans tax-free in 2020
- The CAA extended the availability of this tax-free student-loan repayment assistance option through the end of 2025
- Employer payment can be made to the employee or directly to the lender
- For principal or interest on a “qualifying education loan” incurred by the employee
- Capped at the same standard $5,250 limit under §127, and includes any other forms of assistance (tuition, books, fees, etc.)

What Does the Future Hold for Tax-Advantaged Employer Student Loan Repayment Assistance?

- Could this be the launching point for a permanent expansion of §127? Hard to imagine it sunsetting in 2026 after six years
- For the feature to become even more useful, Congress could allow employee pre-tax contributions (e.g., through the cafeteria plan) to count toward the limit.
- Also should look to index the $5,250 limit for inflation given increases in costs (that fixed amount dates back to 1979!)

Student Loan Repayment Assistance (Through 2025)

1

Qualified Education Loan

The Overarching Definition

- Tax-free educational assistance pursuant to the CARES Act and CAA through 2025 under a §127 qualified educational assistance program is available for an employee's "**qualified education loan**"
- A "**qualified education loan**" is a loan taken out by the employee to pay for the employee's "**qualified education expenses**" within a "**reasonable period of time**" before or after taking out the loan for education provided during an "**academic period**" for an "**eligible student**" to attend an "**eligible educational institution**"

2

Qualified Education Expenses

Total Costs of Attending an Eligible Educational Institution

- Tuition and fees
- Room and board (with limitations)
- Books, supplies, equipment
- Other necessary expenses (such as transportation)

3

Reasonable Period of Time

Non-Issue if Expenses Paid with Student Loans are Part of Federal Postsecondary Education Loan Program

- If not paid with the proceeds of that type of loan, the expenses are treated as paid or incurred within a reasonable period of time if both requirements are met:
  - The expenses relate to a specific academic period; and
  - Loan amount disbursed within period beginning 90 days before and ending 90 days after academic period

Student Loan Repayment Assistance (Through 2025)

4	**Academic Period** *Standard School Term Structure* • Semester • Trimester • Quarter • Other period of study (such as summer school session) as reasonably determined by the educational institution

5	**Eligible Student**
	Employee Enrolled At Least Half-Time
	• Employee enrolled at least half-time in a program leading to:
	  • Degree, certificate; or
	  • Other recognized educational credential
	• Employee is considered enrolled at least half-time if taking at least half of the normal full-time workload for the student's course of study (generally as determined by the educational institution)

6	**Eligible Educational Institution** *Generally Includes Any Accredited School* • Any accredited public, nonprofit, or proprietary (privately owned profit-making): • College, university, vocational school, or other postsecondary educational institution • Institution must also be eligible to participate in a student aid program administered by the U.S. Department of Education (as is the case with virtually all accredited postsecondary institutions)

Working Condition Fringe (§132(d))

The Work-Related Requirements

Significant Limitation on Excludable Expenses

- The education must be job-related, and either maintain or improve job skills, or be expressly required by the employer or by law
- To be excludable, the educational course must not:
  - Be needed to meet the minimum educational requirements of the current job; or
  - Qualify the employee for a new trade or business

§132 Educational Expenses

Standard Education Costs (With No Annual Limit)

- The following can qualify for exclusion as a §132 working condition fringe:
  - Tuition, books, supplies, equipment;
  - Certain travel and transportation costs; and
  - Graduate or undergraduate level courses to retain the job or pay level

Examples

Minimum Job Requirements

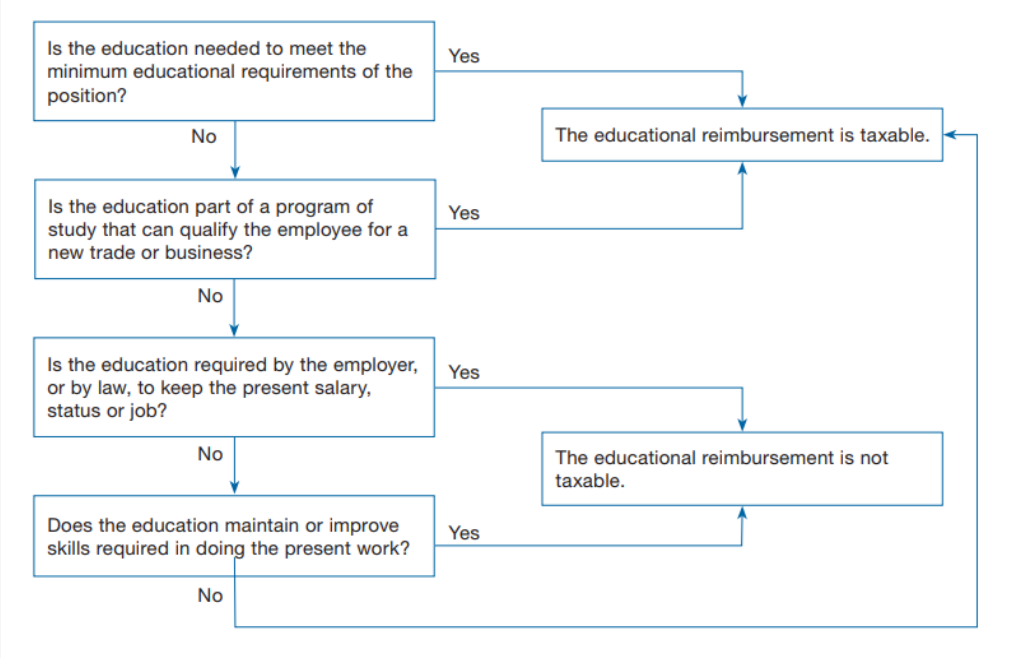
- Excludable: Employer pays computer technician to take a graduate computer course at local university to enhance current job skills
  - Job-related and maintains or improves employee's skills without preparing the employee for a new trade or business
- Taxable: Employee offered a teaching position despite being 40 credits short of standard job requirement because of teacher shortage
  - Reimbursement for those 40 credits is not excludable under §132 because it is needed to meet minimum requirements of present job

Educational Assistance: Working Condition Fringe (§132(d))

Working Condition Educational Fringe Benefit–General Guide

Flowchart from IRS Publication 5137:

https://www.irs.gov/pub/irs-pdf/p5137.pdf



Educational Assistance: Comparison of Options

Comparison of Code Sections Covering Educational Assistance (Abridged)

Table from IRS Publication 5137: https://www.irs.gov/pub/irs-pdf/p5137.pdf

Feature	Section 127 Qualified Educational Assistance	Section 132(d) Working Condition Fringe
Written plan required	Yes	No
Undergraduate courses covered	Yes	Yes
Graduate courses covered	Yes	Yes
Must be job-related	No	Yes
Courses qualifying employee for new trade or business covered	Yes	No
Courses needed to meet minimum job requirements covered	Yes	No
Can discriminate in favor of highly compensated employees	No	Yes
Dollar limitation	$5,250	No

Feature	Section 127 Qualified Educational Assistance	Section 132(d) Working Condition Fringe
Educational expenses covered:		
Tuition	Yes	Yes
Books, supplies, equipment	Yes	Yes
Tools or supplies employee may keep	No	No
Education involving sports, games, hobbies	No**	No**
Meals, lodging or transportation	No	Yes

**Yes, if specifically job related
Note: These are general rules

05

Adoption Assistance

Up to $16,810 Income Tax Exclusion

Adoption Assistance: Section 137 Basics

Adoption expenses are not medical expenses, so they cannot be included in an HRA. However, §137 permits employers to exclude from income up to $16,810 per child in adoption assistance.

General Rules

- IRS limit for excludable employer provided adoption-assistance is $16,810 per child (2024 limit, indexed)
- Employers may choose to offer a lower level of reimbursement (e.g., $10,000)
- Employers must receive reasonable substantiation of eligible adoption expenses to qualify for exclusion
- Adoption assistance is not an ERISA benefit
- Must have a (non-ERISA) plan document with reasonable notification to employees
- Nondiscrimination rules require eligibility be determined on the basis of reasonable classifications
- More-than-5% owners cannot receive more than 5% of the adoption assistance provided in the year

Basic Payroll Rules

- Not subject to federal income tax withholding
- Adoption assistance amounts are subject to payroll taxes (FICA/FUTA) and reported in boxes 3 & 5 of the Form W-2 (SS and Medicare)
- Not reported in Box 1 of Form W-2 as wages
- Also reported on Form W-2 in Box 12 using Code “T”
- Can be included in cafeteria plan as an employee pre-tax contribution, but uncommon because FICA applies and Section 125 restrictions undesirable
- Tax rules differ on how to handle adoption proceedings that have not been finalized depending on whether it is foreign, domestic, or special needs

Adoption Assistance: $16,810 Limit Per Child

§137 Additional Assistance Limit—Not an Annual Limit
• The dollar cap on the adoption assistance credit ($16,810 in 2024) applies to all tax years for the adoption of a child • The unused portion of the credit in one year generally carries over to future years for adoption of the child • An unsuccessful attempt to adopt a child and a subsequent attempt to adopt a different child (whether or not successful) are treated as one effort for these purposes

Example 1	Result 1
• Employee paid $10,000 in an unsuccessful attempt to adopt an eligible child • Employee later pays $8,000 of additional qualified adoption expenses to adopt a different child	• Whether or not the second attempt is successful, the expenses for both domestic adoption attempts will be combined and reported together because the employee was attempting to adopt only one child
Example 2	**Result 2**
• Employee is adopting twins in 2024	• In most cases the employee can take advantage of the credit up to $16,810 per child (2024)
Example 3	**Result 3**
• Employee paid $8,000 in 2022 unsuccessful attempt • In 2023 and 2024, employee pays $10,000 in expenses for successful domestic adoption that becomes final in 2024	• The maximum adoption credit allowable in 2024 is $8,810 because of the $8,000 previously claimed in 2022 for the unsuccessful adoption attempt (treated as same child for credit purposes)

Adoption Assistance: Income Limits

Adoption Assistance Exclusion Phases Out and Eliminated at Higher Income Levels

General Rule

- Income exclusion reduced for those whose modified adjusted gross income exceeds set amount ($252,150 for 2024)
- Income exclusion for adoption assistance becomes completely unavailable for taxpayers at $292,150 (2024)

No Employer Responsibility to Monitor

- The Form W-2 treatment of qualified adoption expenses paid under a qualified adoption assistance program does not depend on whether the employee can ultimately exclude the amounts from income on the individual tax return
- IRS guidance recognizes that qualified adoption expenses paid under an employer program may not qualify or may only partially qualify for the income exclusion because of the income limit or other circumstances
- If all or a portion of the amount paid by the employer is ultimately not excludible, that's a matter that is simply adjusted on the employee's individual income tax return

Summary

- Employers will report adoption assistance amounts (up to the limit) as excluded from income on the Form W-2
- Employers are not responsible for determining whether the income limit or other rule may reduce or eliminate the amount of assistance excludible from income by a particular employee's specific circumstances
- Employers should not simply make all adoption assistance taxable—the dollar limitation applies separately to both the credit and the exclusion, and employees may be able to claim both the credit and the exclusion amounts

Adoption Assistance Interaction with Tax Credit

§137 Exclusion Applies Separately, Reduces Expenses for Adoption Credit

Tax benefits for adoption include both the tax credit for qualified adoption expenses and the §137 exclusion from income for employer-provided adoption assistance

- The dollar limitation ($16,810 in 2024) applies separately to both the credit and the exclusion
  - Taxpayers must claim §137 exclusion amount before claiming any allowable tax credit
- Expenses used for the §137 employer exclusion **reduce the amount of qualified adoption expenses** available for the tax credit
  - Taxpayer cannot claim both the tax credit and the employer exclusion for the same expenses
  - Note that employee may be able to take advantage of more than $16,810 per child with credit and §137 exclusion combined

Example 1

- $16,810 of qualified adoption expenses paid in 2024 for final adoption of an eligible child
  - Employer reimburses $6,810 of those expenses under §137
  - Employee's 2024 income is under the credit phase out limit
  - Expenses allowable for adoption tax credit are $10,000

Example 2

- $21,810 of qualified adoption expenses paid in 2024 for final adoption of an eligible child
  - Employer reimburses $5,000 of those expenses under §137
  - Employee's 2024 income is under the credit phase out limit
  - Expenses allowable for adoption tax credit are $16,810

Example 3

- $35,000 of qualified adoption expenses paid in 2024 for final adoption of an eligible child
  - Employer reimburses $16,810 of those expenses under §137
  - Employee's 2024 income is under the credit phase out limit
  - Expenses allowable for adoption tax credit are $16,810

Domestic, Foreign, and Special Needs Adoptions

Type of Adoption Affects Timing and Amount of Exclusion from Income

- **Domestic Adoption**
  - Adoption of a child who is a U.S. citizen or resident of the U.S. before the adoption effort begins
- **Foreign Adoption**
  - Adoption of a child who is not yet a citizen or resident of the U.S. before the adoption effort begins
- **Special Needs Adoption**
  Three requirements:
  1. Child is a citizen or resident of the U.S. when the adoption effort began;
  2. A state determines that the child can't or shouldn't be returned to his or her parent's home; and
  3. State determines child probably won't be adoptable without assistance provided to the adoptive family
- Not a general "child with special needs" definition—based on whether the state's child welfare agency considers child difficult to place for adoption

Domestic Adoption

- **§137 Exclusion:** Amounts are excludible from employee's income in the **year they are paid** (regardless of when adoption finalized)
- **Tax Credit:** Qualified adoption expenses paid before the year the adoption becomes final are allowable as a credit for the tax year **following the year of payment**

Foreign Adoption

- Adoption expenses paid before and during the year are excludible and allowable as a credit for the **year when it becomes final**
  - Once an **adoption becomes final**, expenses **paid during or after** the year of finality are allowable as a credit for the **year of payment**, whether the adoption is foreign or domestic

Special Needs Adoption

- Generally eligible for the **maximum amount** of credit and §137 exclusion in the year of finality **regardless** of expenses incurred
  - Maximum amount is reduced by any qualified adoption expenses claimed/excluded for the same child in a prior year or years, and the standard income limitations apply

Adoption Assistance Recap: Why, What, Where?

Why Offer:

- Employee loyalty, retention, goodwill, and productivity
- Recruiting and retention benefits
- Foster a family-friendly corporate culture
- Recognize importance of supporting adoptive parents
- Make adoption more affordable
- Help move children from foster care to adoptive homes
- Adoption is not a medical expense, so costs cannot be reimbursed through infertility or other form of specialty HRA for costs of starting a family

Eligible Expenses:

- Reasonable and necessary adoption fees (including agency and application fees)
- Court costs and attorney fees
- Home study
- Travel expense (including amounts spent for meals and lodging while away from home)
- Immigration expenses
- Post-adoption services and counseling
- Other expenses that are directly related to and for the principal purpose of the legal adoption of an eligible child
- Does **not** include costs to adopt child of a spouse

Useful Resources

- IRS Publication 15-B: Employer's Tax Guide to Fringe Benefits
- IRS Form 8839 Instructions: Qualified Adoption Expenses
- IRS Tax Topic No. 607: Adoption Credit and Adoption Assistance Programs
- IRS Nine Facts About the Adoption Credit
- IRS Interactive Tax Assistant: Adoption Credit and Employer-Provided Adoption Benefits
- Dave Thomas Foundation for Adoption: Employer Toolkit

Wrap-up

Takeaways

Fringe Benefits for Employers

Compliance Overview of Five Popular Fringe Benefits

1. Specialty HRA

- Designed to cover expenses traditionally not covered sufficiently by the major medical plan
- Infertility, mental health, autism, abortion/travel
- Need an HRA because reimbursement of a medical expense creates a group health plan
- Post-deductible design preserves HSA eligibility
- HRA must be integrated with employer-sponsored group major medical plan
- COBRA applies to all HRAs, including specialty HRAs
- §105(h) nondiscrimination rules
- PCORI also applies

2. LSA

- Typically designed to reimburse physical, emotional, and financial wellness expenses
- LSAs are intentionally designed to be a taxable benefit to avoid restrictions with tax-advantaged accounts
- Competing theories as to the proper approach to taxation, but virtually all employers tax reimbursements
- Must exclude §213(d) medical expenses to avoid application of group health plan laws such as ERISA, COBRA, HIPAA, ACA, HSA eligibility
- Should exclude expenses that can be provided on tax-advantaged basis through another account

3. Commuter

- Three main forms of commuter benefits: Transit Passes, Vanpool, and Parking
- 2024 monthly limit for Transit Pass/Vanpool and Parking is $315
- Employer contributions count toward limit
- Transit pass reimbursement not permitted (must use debit card or commuter check)
- Employees must forfeit unused amounts at termination (no refunds)
- Employees may change commuter elections monthly for any reason

4. Education

- §127 qualified educational assistance and §132(d) working condition fringe options available to employers
- Most employers use qualified program because expenses do not need to be work-related
- New student loan assistance option available under §127 through the end of 2025
- Qualified programs capped at $5,250/year (not indexed)
- §132(d) working condition fringe has no limit but is restricted to only work-related expenses

5. Adoption

- §137 permits employers to provide up to $16,810 (2024) in adoption assistance excluded from income
- Reimbursements are excluded from income and withholding, but still subject to payroll taxes
- Reported on Form W-2 in Box 12, Code “T”
- Income limitation applies as to whether employee will be able to keep exclusion on individual tax return
- Adoption tax credit also may be available after expenses reduced by the employer exclusion under §137
- Different rules apply based on domestic, foreign, or special needs category of adoption

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Fringe Benefits for Employers

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Thank you

Brian Gilmore

Lead Benefits Counsel, VP

brian.gilmore@newfront.com

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