

## Affordable Care Act: Medical expense reimbursement plans may need amendment



Dale R. Vlasek | Wednesday, February 11, 2015

At one time medical expense reimbursement plans (MERPs) were a very popular fringe benefit, particularly for small employers, and most particularly for small professional corporations maintained by healthcare providers. Under a MERP, a corporation could reimburse its employees (including shareholder employees) for their unreimbursed medical and dental expenses. Reimbursements were generally permitted for anything considered a deductible medical expense under the Internal Revenue Code that was not paid for or, otherwise reimbursed by health insurance covering the individual. A MERP could cover the expenses not only of the employee, but also that of the spouse and dependents of the employee. MERPs typically contained an annual cap, or limit, on the amount of reimbursements which would be allowed to any individual participant.

MERPs were not subject to anti-discrimination rules until the 1980s. As a result, an employer could limit participation to certain classes of employees, such as professional employees. The attractiveness of MERPs diminished as a result of anti-discrimination rules added to the Internal Revenue Code.

The anti-discrimination rules are somewhat complex. Generally, they require that 70 percent of an employer's workforce be eligible to participate, excluding:

- Persons whose accident and health benefits are collectively bargained;
- Non-resident aliens;
- Persons who have not yet reached the MERP's requirements for length of service (which can be up

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to three years), age (which can be up to 25 years), and hours of service (which can be up to 35 hours per week, but in some cases must be as low as 25 hours per week); and

- Seasonal employees.

As a result of the anti-discrimination rules, many employers that had previously maintained MERPs terminated them. However, a number of our clients have continued to maintain MERPs, sometimes with a reduced benefit level. Our experience has been that these clients are primarily hospital-based physician groups such as pathologists or radiologists, in which the only employees are the professionals.

One section of the Patient Protection and Affordable Care Act (the ACA) contains a provision that affects many MERPs. That provision prohibits annual and lifetime benefit limits on essential health benefits for certain types of health plans, including group health insurance plans, individual health insurance plans, and MERPs.

Subject, in effect to one exception, MERPs which contain a cap on annual benefits (as the overwhelming majority of such plans do) will need to eliminate that cap. That exception is a MERP that is integrated with a group health insurance plan which contains no annual or lifetime limit on essential health benefits. When a MERP benefits only employees who are eligible under the employer's group health insurance plan, and that group plan contains no annual or lifetime limit on essential health benefits, the MERP may contain an annual cap or limit on benefits.

However, a MERP with an annual or lifetime limit may not provide benefits for someone who is not a participant in the corporation's group health insurance plan. This would include, for example, the following persons:

- An employee who is not covered under the employer's group health insurance plan because he or she is covered under a spouse's insurance.
- An employee who is not covered under the employer's group health insurance plan because he or she is Medicare eligible and had a Medicare Supplement policy.
- An employee who does not meet the eligibility requirements for participation in the employer's group health insurance plan.
- The spouse of an employee where the spouse is not covered under the group health insurance plan maintained by the employer.
- The dependent of an employee if the dependent is not covered under the group health insurance plan.

Simply put, if the MERP contains a cap on benefits, the employee must participate in the employer's group health insurance plan in order to participate in the MERP. Moreover, the health insurance plan must be a true "group" plan. A collection of individual health insurance policies will not qualify.

Any employer maintaining a MERP will need to modify the plan document to require that eligibility to participate in the MERP requires participation in the employer's group health insurance plan. This requirement must be explicitly stated.

The imposition of this new requirement may result in some employees being dropped from the MERP. If this happens, the employer should consider whether the anti-discrimination rules of Section 105(h) of the Internal Revenue Code described above present an issue.

This new prohibition can present a difficult situation for an employer who has been maintaining a MERP

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that contains a cap. These have been very popular and are highly tax effective fringe benefits. However, ignoring the ACA requirement is not an option; it exposes the employer to penalties of \$100 per day for each participant in the MERP who is not also participating in the employer's group health plan. There are some options which, individually or in combination, might solve the problem:

- Revise the MERP to be a dental and vision care expense reimbursement plan only. Dental expenses and vision expenses (eye glasses) are not subject to the ACA provision, and could be provided under an expense reimbursement plan that contained a cap, even where the participating employee or the non-employee spouse or dependent was not covered by the group health insurance plan.
- Adopt a flexible spending account plan under which employees could elect to have up to \$2,550 (for 2015) of their compensation set aside and used to reimburse eligible expenses.
- Reach an agreement with the employee under which that employee's base compensation is increased to offset the loss of medical expense reimbursement amount, without conditioning the increase in the employee's base compensation to the employee's actual medical expenses incurred.

Some employers already use this third alternative in the sense that medical reimbursement actually made to an employee is considered part of that employee's annual "compensation package" with the result that employees who have smaller amounts of medical expense reimbursements receive an additional compensation payment. This practice does create its own issues under the Internal Revenue Code. Where an employee essentially has a choice between taxable or nontaxable payments (as would be the case where an employee has the option of turning in expenses for reimbursement, or not turning them in and receiving the same amount as taxable compensation), unless certain requirements of the Internal Revenue Code are met with respect to the type of benefits that can be provided and the method of electing the benefits, the reimbursements for medicals expenses will be taxable. A full discussion of all of this is beyond the intended scope of this article.

In summary, if your employer maintains a MERP which reimburses for expenses beyond dental and vision care expenses, and which is not a qualifying flexible spending account plan, then you need to review your plan to make certain that it meets the new requirements.

For more information, please contact one of the attorneys listed below.



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