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Over the Years, Insurance Has Become an Important Employee Benefit

By Barry Kozak[*]

INTRODUCTION

"Prior to World War II, few Americans had health insurance, and most policies covered only hospital room, board, and ancillary services."[1] A provision was added to the Internal Revenue Code in 1954 that began the practice of Congress specifically excluding the value of an "employer's contributions to accident and health plans benefitting employees" from the recipient employees' gross income, and clarified that "such contributions had always been deductible as business expenses."[2] "The growth of hospital and surgical insurance was most rapid in the [1950s] when the concept of health insurance was becoming an important fringe benefit in employer-employee negotiations. The growth rate moderated in the sixties when insurance for other types of care such as prescription drugs and dental care was being pursued in contract negotiations."[3]

The business community and the unions, like the AFL-CIO, had continually opposed a federally preemptive law (albeit for different reasons), but, as separate and varied pension plan regulation schemes started boiling up in several different states in the early 1970s, those lobbying groups changed their minds, and started to strongly encourage the passage of the Employee Retirement Income Security Act of 1974, as amended (ERISA).[4] As Congress debated whether ERISA should preempt state laws on pension plans, a trial court in 1973 prohibited Monsanto, a manufacturing firm, from self-funding a health and disability insurance plan for its employees because states regulated insurance, and a self-funded employee benefits trust used to fund and deliver employee benefits promises could not possibly fit under the [Missouri] state's insurance regulatory jurisdiction.[5] As this major case chilled the efforts of other employers in finding creative ways to provide health insurance as an employee benefit, many observers and historians remind us that the federal regulation of employer-provided health and welfare benefit plans was basically a last-minute addition to ERISA before it was going to be voted on by Congress (note it is not ERIHWSA, as Health and Welfare plans are not even in the law's name). ERISA continued to change the landscape of employee health and welfare benefit plans, especially as the Supreme Court extended the reach of ERISA pre-emption during the 1980s, which

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[1] Employee Benefit Research Institute, *History of Health Insurance Benefits* (Mar. 2002), https://www.ebri.org/publications/facts/index.cfm?fa=0302fact.

[2] *Id.* The current version of the Internal Revenue Code is the Internal Revenue Code of 1986, as amended (I.R.C.). All section references herein are to the I.R.C., and the regulations thereunder, unless otherwise indicated.

[3] Marjorie Smith Carroll and Ross H, Arnett, III, *Private Health Insurance Plans in 1977: Coverage, Enrollment and Financial Experience*, 1 Health Care Fin. Rev. 3 (1979).

[4] *See, e.g.,* James A. Wooten, *A Legislative and Political History of ERISA Preemption*, Part 2, 15 Journal of Pension Benefits 5, 10 (2007).

[5] James A. Wooten, *A Legislative and Political History of ERISA Preemption*, Part 1, 14 Journal of Pension Benefits 31, 34 (2006).

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was the period when states were experimenting with health policy to contain costs (such as insurance mandates, medical high-risk pools, and uncompensated care pools). In addition, organic changes were gestating within the insurance markets themselves (such as the rise in self-insurance and the growth of managed care in the shadow of older adults finally being covered *en masse* through the Medicare program introduced in 1965).[6] As we move into the present, ''The most prominent type of welfare benefit is group health insurance; but other common welfare benefits include dental, vision, disability, life insurance and long-term care coverage.''[7]

This article explores the current environment where various forms of insurance are offered as compensation in the form of benefits, and paid in addition to salaries, to attract, retain, and reward good employees for their human capital. While health insurance for the employee (and not for his or her family) clearly benefits the employer with a quantifiable return on investment, all other forms of insurance, whether limited to the employee or extended to the employee's family (such as accident insurance, disability insurance, life insurance, long-term care insurance, automobile insurance, travel insurance, and pet insurance) give some peace of mind to the employee, and the only informal benefit back to the employer is the proverbial, yet unquantifiable, ''happy employees are productive employees.''

First, this article will summarize the ERISA and income tax issues an employer must consider before offering any type of employee benefit, but especially the insurance products that occupy the space of health and welfare benefits. Then, the most common types of insurance products currently offered as an employee benefit will be separately evaluated, including a summary of how cafeteria plans or similar tax-favored accounts can assist employees that need to pay a portion of premiums or other out-of-pocket costs. Finally, the article looks at the more complicated and murky world of offering various insurance benefits through a qualified retirement plan. The article concludes with some policy analysis, including a quick discussion of bills that have been introduced in the current Congress.

[6] *See, e.g.,* ERISA and Health Plans, EBRI Issue Brief #167 | Special Report SR-31 (1995), Executive Summary, https://www.ebri.org/publications/ib/index.cfm?fa=ibDisp&content_id=75.

[7] Stumpff, 395 T.M., *VEBAs and Other Welfare Benefit Funding Arrangements*, I.A.2.a.

ERISA AND INCOME TAX ASPECTS OF INSURANCE

ERISA Plans

Whenever an employer offers an employee benefit, the first question should be whether or not the benefit is being offered under an ERISA plan.[8] ERISA defines an ''employee welfare benefit plan'' as

> any plan, fund, or program which was heretofore or is hereafter established or maintained by an employer or by an employee organization, or by both, to the extent that such plan, fund, or program was established or is maintained for the purpose of providing for its participants or their beneficiaries, through the purchase of insurance or otherwise, (A) medical, surgical, or hospital care or benefits, or benefits in the event of sickness, accident, disability, death or unemployment, or vacation benefits, apprenticeship or other training programs, or day care centers, scholarship funds, or prepaid legal services, or (B) any benefit described in section 186(c)[9] of this title (other than pensions on retirement or death, and insurance to provide such pensions).[10]

Under Department of Labor (DOL) regulations, payroll practices (such as the delivery of overtime pay, shift premiums, holiday premiums, weekend premiums, and remittance of compensation during periods of paid leave, sick leave, military leave, service on a jury, training leave, and educational leave), on-premises facilities, holiday gifts, sales to employees, hiring halls, remembrance funds, strike funds, industry advancement programs, certain group or group-type insurance programs (where the employer does not make any contributions, and has a very minimal

[8] Under ERISA §4(a), ERISA covers any employee benefit plan if it is established or maintained by any employer engaged in commerce or in any industry or activity affecting commerce and/or by any employee organization or organizations representing employees engaged in commerce or in any industry or activity affecting commerce. However, ERISA §4(b) specifically excludes governmental plans and church plans, among others.

[9] Title 18 of the United States Code contains all federal laws related to labor and employment, and chapter 7, labor-management relations, and §186(a) places a restriction on certain payments, loans, or gifts to be paid by the employers or unions to ''any person who acts as a labor relations expert, adviser, or consultant,'' and §186(b) prohibits any such person from requesting a payment or other ''thing of value;'' however, §186(c) contains an expansive list of exceptions, and those excepted benefits can be promised, funded and delivered through an ERISA plan.

[10] ERISA §3(1).

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role in being the conduit, and merely offers insurance policies to employees for them to purchase on a totally voluntary purpose), and unfunded scholarship programs, are not ERISA plans.[11]

If a plan or arrangement is an ERISA plan, then the employer must comply with notice and disclosure requirements[12] (which includes the absolute need for a written plan document and the delivery of a summary of the plan provisions and other communications to the plan participants), fiduciary duties,[13] and the criminal and civil enforcement framework[14] (including preemption, and mandatory and systematic reviews of benefits claims that have been denied). In addition, certain health plans are subject to the mandates of COBRA[15] and HIPAA.[16] Note that health and welfare benefit plans are wholly excluded from the minimum participation, vesting, accrual, and distribution rules[17] (which means that benefits such as retiree health benefits can be taken away at will under most circumstances) or the minimum funding rules[18] that attach to retirement pension benefit plans.

Income Tax Issues

An independent, but very important, factor is how an employer-provided benefit will be taxed to participants and their beneficiaries. Individuals who are employed by an employer will include in their gross incomes their "compensation for services, including fees, commissions, fringe benefits, and similar items."[19] Having employer-provided insurance clearly fits in the "similar items" category, so the value of the benefit should, under that provision, be imputed into his or her gross income. The key to navigating the I.R.C., especially this provision, is the opening sentence: "Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items."[20] Congress can therefore, through another provision of the I.R.C., allow the value of a component of compensation to be permanently excluded from gross income, deferred and included in a future year's gross income after certain contingencies and events happen, or, even if included in gross income in the current year, allow for a lower tax rate to be applied to that portion of compensation, or allow certain deductions or credits to ultimately allow the individual employee to reduce the current year's income tax liability.

However, because of the way that the I.R.C. is written, and the business practices employers use to unilaterally decide which benefits to offer, it is generally incumbent upon the employer to find these specific provisions, and then must understand the thresholds, limitations, and other parameters they need to comply with so that the desired income tax attributes of the employee benefit is actually enjoyed by those employees receiving the employer-provided benefit.

Unlike the income tax rules for qualified retirement plans, which allow business owners to be considered "employees" and therefore they can participate in the plan and enjoy all of the income tax benefits that follow retirement benefits,[21] the income tax rules for health, welfare, and fringe benefit plans are not so liberal, and in many cases, 2% shareholders in S corporations and partners in partnerships are not allowed to exclude the value of health and welfare benefits (but as flow-through entities, these business owners might have the ability to use offsetting deductions or credits to reduce their personal taxable incomes after the business taxes have flowed through). An additional concern is that only common-law employees, as opposed to independent contractors, can participate in the employee benefit plans, and enjoy the resulting income tax benefits.[22]

From the employer's perspective, in addition to jumping through whatever hoops it needs to jump through to ensure any benefits offered to employees meet the requirements for tax-favored status to be afforded to the them, which might include the avoidance of discrimination in favor of the highly compensated employees, the employer generally seeks to deduct all costs associated with the funding and delivery of the benefits. Whether the business entity is taxed as a corporation, thus subject to its own income tax liability, or as a pass-through entity, where the income tax attributes of the business pass through to the business owners, the starting point is a general business deduction: "[t]here shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or

[11] 29 C.F.R. §2510.3-1(b) through §2510.3-1(j).

[12] ERISA §101 through §111.

[13] ERISA §401 through §414.

[14] ERISA §501 through §521.

[15] ERISA §601 through §609, reflecting the amendments to ERISA made through the Consolidated Omnibus Budget Reconciliation Act of 1985, Pub. L. No. 99-272.

[16] ERISA §701 through §734, reflecting the amendments to ERISA made through the Health Insurance Portability and Accountability Act of 1996, Pub. L. No. 104-191.

[17] ERISA §201 through §211.

[18] ERISA §301 through §306.

[19] §61(a)(1).

[20] §61(a). While the entire I.R.C. is codified in Title 26 of the United States Code, Subtitle A contains all of the provisions regarding income taxes.

[21] §401(c).

[22] *Nationwide Mut. Ins. Co. v. Darden*, 503 U.S. 318, 323–324 (1992).

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business, including — a reasonable allowance for salaries or other compensation for personal services actually rendered.''[23] There are three stumbling blocks should the employer ever be audited by the IRS: (1) proving that the expenses incurred in providing employee benefits are ordinary; (2) proving that the expenses are necessary; and, (3) proving that the salaries or compensation, once the value of the benefits are added in, are reasonable. These are not necessarily insurmountable hurdles, but upon audit, the employer still needs to expend time, energy, and resources in keeping records and convincing the IRS. For certain employee benefits, however, there are provisions of the I.R.C. that specifically allow the deduction if the employer complies with certain rules in offering the benefits. Therefore, when appropriate, the employer should look for the special deduction rules. The cost of more predictable deductions, however, is strict adherence to the rules prescribed by Congress. Additionally, if employers choose to fund health and welfare benefits through certain vehicles and arrangements, such as a Voluntary Employee Benefits Association (VEBA) or a Multiple Employer Welfare Arrangement (MEWA), then an internal specialist or outside counsel will need to assist the employer in establishing and maintaining the funds properly. This will allow them to take advantage of the various tax attributes that flow to employers and employees only after compliance with a complicated set of rules is confirmed.[24]

COMMON TYPES OF INSURANCE OFFERED AS AN EMPLOYEE BENEFIT

Accident and Health

Health insurance is one of the most common types of insurance that employees desire and that employers provide.[25] However, the very discussion of all of the issues with health insurance is truly a specialty area in and of itself for employee benefits consultants, so no employer should attempt to navigate the health plan waters without expert internal or external counsel, or at least a thorough treatise.[26] Although a broad overstatement, all of the various income tax issues for health and accident insurance are individually, and collectively, found in §104, §105, and §106.

> In general, §106(a) provides that gross income of an employee does not include employer-provided coverage under an accident or health plan. Under §106(a), an employee may exclude from income premiums for accident or health insurance coverage that are paid by an employer. Also, under §105(b), an employee may exclude amounts received through employer-provided accident or health insurance if those amounts are paid to reimburse expenses incurred by the employee for medical care (of the employee, the employee's spouse, or the employee's dependents, as well as children of the employee who are not dependents but have not attained age 27 by the end of the taxable year) for personal injuries and sickness. To the extent amounts received through employer-provided accident or health insurance are paid without regard to the amount of expenses incurred by the employee for medical care, the amounts are not excluded from gross income because the amounts are not paid to reimburse expenses incurred by the employee for personal injuries and sickness.
>
> Generally, amounts received through accident or health insurance for personal injuries or sickness are excluded from gross income under §104(a)(3). This exclusion does not apply, however, if the amounts are either (1) attributable to contributions by the employer that were not includible in the gross income of the employee or (2) paid by the employer. See §1.104-1(d); for this purpose, salary reduction under a §125 cafeteria plan is treated as an employer contribution, and not an employee contribution.[27]

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[23] §162(a)(1).

[24] *See, e.g.,* Stumpff, 395 T.M., *VEBAs and Other Welfare Benefit Funding Arrangements*.

[25] According to the 2016 Employee Benefits Survey by the Society for Human Resource Management at p. 32 (hereafter 2016 SHRM Survey, available at https://www.shrm.org/hr-today/trends-and-forecasting/research-and-surveys/Documents/2016%20SHRM%20Employee%20Benefits%20Full%20Report.pdf) (registration or membership required to view), 96% of employers surveyed in 2016 offer a health care plan of any type; 96% offer dental insurance; 94% offer prescription drug coverage bundled with medical insurance; 87% offer vision benefits; 85% offer a mail-order prescription program; and 85% offer mental health coverage.

[26] *See, e.g.,* Cowart, 389 T.M., *Medical Plans — COBRA, HIPAA, HRAs, HSAs and Disability*; Moran, 390 T.M., *Reasonable Compensation*; and Maule, 514 T.M., *Tax Incentives to Hire, Retain, or Compensate Employees*.

[27] CCA 201703013. Although a Chief Counsel Advice memorandum responds to a specific taxpayer's unique situation and request for assistance, and any advice ''may not be used or cited for precedent,'' the IRS Chief Counsel's summary of existing law, before application to any facts, becomes quite informative in and of

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Because health and accident insurance is one of the most popular types of insurance that an employer will provide as an employee benefit, and with the complexity of what the employer must do to comply with three different sections of the I.R.C., employers should hire appropriate counsel to find the right products, vendors, and administrators. Some basic decisions that the employer needs to make include: (1) whether the insurance will only cover employees while still actively employed, after they completely retire, or if the employer has a written phased retirement program, while they are in a phased retirement period; (2) how inclusive the term family will be if more than employee-only insurance is offered,[28] (3) whether the business itself will act as a quasi-insurance company and self-fund the insured promises, even if some of the administrative functions are outsourced to a third party vendor and even if the employer mitigates risks through reinsurance, or if it simply pays premiums to an actual insurance company; and, (4) whether the employer will bear the entire cost or require the employees to pay a portion out of their paychecks.

If the employer passes some of the costs of the health insurance over to the employees, then the employer has a choice of several types of tax-free investment vehicles it can voluntarily offer to allow the employees to defer a portion of compensation into the savings vehicles so that such deferrals are also excluded from the respective employees' gross incomes. The first are Health Savings Accounts,[29] which have many rules and restrictions,[30] but which basically allow an individual who is covered through a ''high deductible health plan'' (HDHP) to accumulate a balance through employee and/or employer contributions, and to spend down the account on qualified medical expenses. Alternatively, if the employer offers employees any health plan that does not meet the ''high deductible health plan'' definition, or if the employer offers a supplemental plan in addition to the HDHP, then the employer can offer a similar accumulation vehicle for qualified medical expenses, but possibly even more complicated, which is generally called a ''cafeteria plan''[31] if the participants can choose among two or more benefits consisting of cash and qualified benefits, or specifically called a ''Health Flexible Spending Arrangement''[32] if the only qualified benefit on the cafeteria-type menu is to cover out-of-pocket costs for a health or accident insurance plan.[33]

Life Insurance

There are several ways for an employer to look at offering life insurance to employees as an employee benefit. One of the most common ways is through a group term-life program. If the employer limits the face amount of life insurance to $50,000 for an active employee, then the value of the life insurance coverage is excluded from the employee's gross income;[34] however, if an employee voluntarily pays for additional coverage or if the employer pays for additional coverage, then that additional value is quantified and imputed into the employee's gross income.[35] Additionally, the ''cost of employer-provided group-term life insurance on the life of an employee's spouse or dependent, paid by the employer, is not taxable to the employee if the face amount of the coverage does not exceed $2,000.''[36]

About 80% of employers surveyed in 2016 offered company-paid group life insurance.[37] The main reason is that group term life insurance products are easy for the employers to purchase, and then, the individual employees simply answer a few basic medical questions in order to enroll.

Employers might choose to purchase corporate-owned life insurance, which covers the lives of key employees, so that if they die unexpectedly, either the

itself.

[28] An employee welfare benefit plan provides benefits to participants (which, under ERISA §3(7), includes *employees* and their beneficiaries). Then, under ERISA §3(8), a beneficiary is ''a person designated by a participant, or by the terms of an employee benefit plan, who is or may become entitled to a benefit thereunder.'' In a health or welfare benefit plan, the term beneficiary is loosely used to indicate individuals invited to participate due to the employee's eligibility status and the plan language allowing certain members of his or her family to participate as non-employees, but has a specific meaning under COBRA.

[29] §223.

[30] *See, e.g.,* Cowart, 389 T.M., *Medical Plans — COBRA, HIPAA, HRAs, HSAs and Disability*, XI.

[31] §125(d).

[32] §125(i).

[33] *See, e.g.,* Raish, 397 T.M., *Cafeteria Plans.*

[34] §79(a)(1).

[35] §79(a). The imputed cost of coverage in excess of $50,000 must be included in income, using the IRS Premium Table, and are subject to social security and Medicare taxes. See IRS Publication 15-B, *Employer's Tax Guide to Fringe Benefits* (2017, or as updated) for the Premium Table.

[36] See ''Group-Term Life Insurance,'' available at https://www.irs.gov/government-entities/federal-state-local-governments/group-term-life-insurance. This additional exclusion is addressed in Notice 89-110, 1989-2 C.B. 447 (as modified with respect to life insurance costs by REG-142695-05, 72 Fed. Reg. 43,938, 43,944 (Aug. 6, 2007)) and is described as a *de minimis* fringe benefit under §132(a)(4).

[37] 2016 SHRM Survey, at 25. *See* n. 25, above. Additionally, life insurance for dependents increased from 55% in 2012 to 61% in 2016, and nearly one-quarter of organizations (23%) offered in 2016 accelerated death benefits for financial assistance in the case of a terminal illness.

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anticipated lost revenue will be replaced, or any buy-out agreement amounts needed to be paid to their surviving spouses will be funded. However, such exclusive benefits fall more in the category of executive compensation, and employers are free to provide any form of life insurance to a select group of management, but the value of the insurance will likely be imputed into the executives' gross incomes even though the employer will likely be able to deduct the costs as ordinary and necessary expenses.

Disability Insurance

"56 million Americans, or 1-in-5, live with disabilities."[38]

> Disability is something many Americans, especially younger people, think can only affect the lives of other people. Tragically, thousands of young people are seriously injured or killed, often as the result of traumatic events. Many serious medical conditions, such as cancer or mental illness, can affect the young as well as the elderly. The sobering fact for 20-year-olds, insured for disability benefits, is that more than 1-in-4 of them becomes disabled before reaching retirement age.[39]

Employers usually require employees who become injured, or become afflicted with a disease, to use up paid time off (such as vacation days and sick days) and unpaid time off if appropriate (such as family medical leave) before any form of short-term disability benefits begin to be paid in lieu of salary. Once on long-term disability, even though the individual is still considered an employee and must be re-employed once physically and mentally able to return to work,[40] the employer generally proceeds as if the individual will not return to work, and makes alternate work-force decisions. Of employers surveyed in 2016, 70% offered short-term disability insurance benefits[41] (generally starting after a 1- to 2-week absence, for up to six months of leave, at 100% of pre-leave compensation),[42] and 77% offered long-term disability insurance benefits[43] (generally starting after six months of absence, and maybe 50% to 60% of pre-leave compensation).[44] The taxation of disability benefits is identical to the taxation of health benefits.[45]

Long-Term Care Insurance (LTCI)

When an individual taxpayer determines his or her individual federal income tax liability, deductions allowed for medical care include "amounts paid for the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body"[46] as well as "amounts paid for transportation" to receive the medical care.[47] Most health insurance policies will stop there, and at most, cover only direct and indirect services where a licensed medical professional is doing something to the body that ameliorates the body in some positive manner. The introduction of Medicare and Medicaid in 1965, although primarily for older Americans who are no longer working, set the standards for health insurance products offered to adults who have not yet attained age 65, and who are likely actively employed.

Long-term care is different from medical care, in that any person (even a non-medically trained family member) is assisting the infirmed person with activities of daily living — not to make the person better, but basically preventing the person from getting worse (i.e., maintenance of a chronic disease or multiple chronic diseases).

> Long-term care includes many types of chronic care services needed because of physical or mental disability. Individuals needing long-term care have difficulty performing some functions involved in normal daily living, such as bathing, dressing, toileting, eating, and moving from one location to another without assistance. They may also have mental impairments, such as Alzheimer's disease, which may require supervision and assistance with tasks such as taking medications. Although a chronic physical or mental disability may occur at any age, the older an individual becomes, the more likely a disabling condition will develop or worsen. Nearly one-seventh of the nation's current elderly population—an estimated 5.2

[38] Social Security Administration Facts, Disability Fact 3, https://www.ssa.gov/disabilityfacts/facts.html.

[39] *Id.*

[40] *See, e.g.,* Susan Nathan, *Short Term Disability Basics*, Balance.com (updated Oct. 19, 2016), https://www.thebalance.com/short-term-disability-basics-1177839.

[41] 2016 SHRM Survey, at 36. *See* n. 25, above.

[42] *See, e.g.,* The basics of short-term disability insurance, Insure.com (updated Nov. 12, 2014), http://www.insure.com/disability-insurance/short-term-disability.html.

[43] 2016 SHRM Survey, at 36. *See* n. 25, above.

[44] *See, e.g.,* The basics of long-term disability insurance, Insure.com (updated June 3, 2016), http://www.insure.com/disability-insurance/long-term-disability.html.

[45] Read, collectively, §104, §105, and §106. *See* n. 27, above.

[46] §213(d)(1)(A).

[47] §213(d)(1)(B).

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> million—have a limitation in either activities of daily living (ADL), instrumental activities of daily living (IADL), or both. More than one-third of these have limitations in 2 or more ADLs.[48]

The trouble is that the individual market for long-term care insurance has many problems, and not enough individuals purchase proper amounts of long-term care insurance while they are young and healthy, and when the resulting premiums are low.[49] While federal employees receive long-term care insurance as an employee benefit,[50] only 27% of private employers surveyed in 2016[51] offered the ability for their current employees to purchase LTCI policies that could usually be portable if an employee terminated employment.

Unfortunately, it seems that Congress has a problem with employers providing long-term care insurance as an employee benefit. First, long-term care insurance is specifically excluded from the list of qualified benefits that can be offered by an employer through a cafeteria plan.[52] Second, although Congress passed the CLASS Act in 2010 with strict guidelines put on the shoulders of the Secretary of the Department of Health and Human Services, it promptly revoked the law when the Secretary announced that she couldn't comply with their edicts.[53] Under the law, the Secretary of HHS was required to develop a program where employers could provide long-term care insurance as an employee benefit for a very minimal premium (because the U.S. government would act as the insurer rather than any private for-profit insurance companies), and where the benefit would be in the range of $50 per day to cover long-term care costs (under today's prices, most people in need of long-term care will pay about $150 per day, so this was only meant to be a base level of insurance). In the election season of 2012, Secretary Sebelius indicated that her department could not make the program actuarially sound based on the parameters of the law, and then right after President Obama was re-elected, the entire CLASS Act was repealed through the general year-end budget/debt-ceiling/fiscal-cliff compromise.[54]

Actual long-term care costs are a lot higher than most people expect,[55] and unless insurance has been purchased, the current costs need to come out-of-pocket as needed, a family member needs to provide care-giving services for free, or the individual needs to be indigent and apply for a welfare program called Medicaid. Although not technically insurance under the context of this article, because many current retirees do not have adequate long-term care insurance, do not have the means to cover all of the long-term care costs out of pocket, and yet are not indigent enough to qualify for Medicaid, older adults needing long-term care oftentimes rely on their adult children to be their caregivers. However, these adult caregivers are frequently still gainfully employed. Employers can also make accommodations to their employees by providing support, education, and time off or flexible work schedules, even if not actual cash compensation, so that employees who are caregivers become more productive by minimizing presenteeism and absenteeism.[56]

Other Types of Insurance That Have No Specific Income Tax Benefits

An employer that offers any other forms of insurance, or that offers insurance benefits that are outside of the strict parameters above, has two obstacles. First, the employer must determine each year that the benefits are an ordinary and necessary cost of doing business and that, when added to the salaries and other employee benefits, each employee's compensation remains reasonable if it wants to deduct the cost of funding and delivering these non-statutory insurance benefits. Second, the employer must properly communicate to the employees receiving these benefits that the value might be imputed into their compensation, and then must quantify the individual values imputed into each such employee's compensation. On the other hand, if the employer can determine that such non-statutory insurance benefits meet the defini-

[48] *Long-Term Care Insurance: Better Information Critical to Prospective Purchasers, Testimony before the Special Committee on Aging*, U.S. Senate, by U.S. General Accounting Office, GAO/T-HEHS-00-196 at p. 3 (Sept. 13, 2000), available at http://www.gao.gov/assets/110/108635.pdf.

[49] *See, e.g., Overview of the Long-Term Care Insurance Industry*, National Care Planning Council, https://www.longtermcarelink.net/eldercare/long_term_care_insurance.htm, last visited April 17, 2017.

[50] https://www.ltcfeds.com/.

[51] 2016 SHRM Survey, at 8. *See* n. 25, above. However, 20 years ago, in 1996, the same survey showed that 32% of employers offered long-term care insurance to employees.

[52] §125(f)(2). *See* n. 31, above.

[53] The Community Living Assistance Services and Supports Act (CLASS Act) was enacted as Title VIII of the Patient Protection and Affordable Care Act of 2010, Pub. L. No. 111-148.

[54] American Taxpayer Relief Act of 2012, Pub. L. No. 112-240.

[55] *See, e.g.,* AARP, Long-Term Care Calculator, http://www.aarp.org/relationships/caregiving-resource-center/LTCC/.

[56] *See, e.g.,* National Alliance for Caregiving (NAC) and AARP, *Caregiving in the U.S. 2009* (Bethesda, MD: NAC, and Washington, DC: AARP, Nov. 2009). Funded by the MetLife Foundation. (An estimated 61% of family caregivers of adults age 50 and older are currently employed either full-time (50%) or part-time (11%)).

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tion of a *de minimis* fringe benefit,[57] a no-additional cost service,[58] qualified employee discount,[59] or working condition fringe,[60] based on the services and products that the employer provides to customers, then the employer can take a deduction under the fringe benefit rules and the value to the employee receiving the fringe benefit is excluded from gross income. In order to attract, retain, and reward a particular workforce, an employer may need to provide employee benefits that Congress has not yet favored under the I.R.C. The most common forms of other insurance benefits that employers offer are: travel accident insurance if travelling in the capacity of an employee for work (41%); pet insurance (9%); personal use automobile insurance (6%); homeowners insurance (5%); rental residential insurance (3%); divorce insurance (3%); and mortgage insurance (1%).[61]

INSURANCE IN QUALIFIED RETIREMENT PLANS

A qualified plan is a very complicated endeavor in and of itself, and the primary reason for any employer to fund, promise, and deliver retirement benefits through a qualified plan is so that the taxation of retirement benefits is deferred until the years that the employee actually receives the benefits,[62] and the employer deducts the contributions in the year they are deposited into a trust.[63] The rules for qualified plans are quite extensive,[64] so unless the employer has a sophisticated internal Human Resources department or outside benefits counsel, the retirement plans should only be invested in non-insurance vehicles, and only statutory death and disability benefits should be made available.

Life Insurance

A qualified plan, whether defined contribution or defined benefit in design, is supposed to primarily provide retirement benefits, but can be used to provide death benefits, as long as they are incidental.[65] The benefits are considered merely incidental if the following rules apply.

Defined contribution plans. If the employer contribution portion of the account balance is used to purchase insurance contracts, then the premiums are limited to 50% if used to purchase whole life insurance and to 25% if used to purchase term life insurance;[66] however, if the voluntary employee contributions portion of the account balance is used to purchase life insurance, then the 50% and 25% limits do not apply.[67]

Defined benefit plans. The face amount of death benefits cannot exceed 100 times the participant's projected monthly benefit.[68] Also, where the employer desires minimum variance with annual funding requirements and does not want to engage an Enrolled Actuary to perform annual valuations, then all plan assets can be invested with an insurance company that provides whole life contracts for each participant where the level premiums are paid fully and timely for all years the participant is employed until normal retirement age and where the death benefits equal the benefits promised under the plan.[69]

Longevity Insurance (the New QLAC Options in DC Plans)

A relatively *new kid on the block* is the option for an employer that sponsors a defined contribution plan to allow employees to voluntarily purchase longevity insurance, so that a portion of their lump-sum account balance can be used currently to purchase a deferred annuity. Longevity risk is defined as living beyond life expectancy and therefore outliving assets and financial resources.[70] One way to mitigate the risk is to purchase a deferred annuity that only begins if the individual lives to a certain age.

A qualifying longevity annuity contract ''is an annuity contract that is purchased from an insurance company for an employee and that . . . satisfies each of the following [seven] requirements:''[71]

1. The premium limitation is the lesser of a dollar limitation or a percentage limitation. The dollar

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[57] §132(a)(4).

[58] §132(a)(1).

[59] §132(a)(2).

[60] §132(a)(3).

[61] 2016 SHRM Survey. *See* n. 25, above.

[62] §402.

[63] §404.

[64] §401(a) has a laundry list of 37 absolute or conditional requirements for a plan to maintain its qualified status, tested every year.

[65] §401(a)(9)(G).

[66] Rev. Rul. 76-353, 1976-2 C.B. 112 (differentiating between level premium whole life insurance and decreasing amount whole life insurance). The initial 50% limit is set forth in Rev. Rul. 74-307, 1974-2 C.B. 126.

[67] Rev. Rul. 69-408, 1969-2 C.B. 58. Please note that while still relevant guidance, it pre-dates the addition of §401(k) to the I.R.C. allowing for elective salary deferrals which, under §402(g)(3), are considered to be employer contributions.

[68] Rev. Rul. 2004-21, 2004-10 I.R.B. 544.

[69] §412(e)(3). Because the description of these contracts historically had been codified at §412(i) before amendments by the Pension Protection Act of 2006, people may continue to refer to them as §412(i) plans.

[70] ''Managing Post-Retirement Risks: A Guide to Retirement Planning,'' Society of Actuaries (2011), available at https://www.soa.org/files/research/projects/post-retirement-charts.pdf.

[71] Reg. §1.401(a)(9)-6, Q&A-17(a), as amended by T.D. 9673,

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limitation is basically $125,000, as adjusted for inflation, and the percentage limitation is basically 25% of the employee's account balance as of that date.

2. The contract provides that distributions under the contract must commence not later than a specified annuity starting date that is no later than the first day of the month next following the 85th anniversary of the employee's birth.

3. The longevity annuity contract, which will be issued by an insurance company, must otherwise satisfy all of the existing requirements of required minimum distributions, with which the plan administrator must comply.

4. The contract does not make available any commutation benefit, cash surrender right, or other similar feature.

5. There are limited death benefit options, more so if the beneficiary is not a surviving spouse.

6. The issuing insurance company must intend for the contract to be a QLAC.

7. The contract must not be a form of variable annuity contract, either expressly or inadvertently.

The amounts used to purchase a compliant QLAC, and then the QLAC itself going forward, are removed from the numerator when the minimum required contributions for that plan participant are determined.

Because QLACs are relatively new, they haven't seem to have grown in popularity. According to a recent survey, only 8% of workers surveyed indicated that they were "very interested" in QLACs and 30% indicated that they were "somewhat interested"; on the other hand, a total of 59% indicated that they weren't that interested or weren't at all interested.[72] Because longevity risk is a growing concern for individuals as they age, and because these lifetime income products do not seem to be readily available to employees outside of a qualified defined contribution retirement plan, hopefully plan sponsors will begin taking advantage of QLACs, and think of them as an employee benefit within an employee benefit.

Offering Retiree Health Benefits

A qualified pension plan may provide for the payment of benefits for sickness, accident, hospitalization, and medical expenses of retired employees, their spouses, and their dependents, but only if such benefits are subordinate to the retirement benefits provided by the plan.[73] In addition, a separate account must be established to which the employer makes reasonable and ascertainable contributions that are used to satisfy the plan's obligations to pay such benefits. It must be impossible, at any time prior to the satisfaction of all liabilities under the plan to provide such benefits, for any part of the corpus or income of such separate account to be used for any purpose other than providing such benefits. After the plan's obligations have been satisfied (for example, if the plan were terminated or future medical benefits ceased pursuant to a plan amendment), any excess contributions must revert to the employer rather than being applied to fund retirement benefits. Finally, in the case of an employee who is a key employee, a separate account must be established and maintained for such benefits payable to such employee (and his spouse and dependents) and such benefits only may be payable to such employee (and his spouse and dependents) from such separate account.[74]

VEBAs and MEWAs might also be used to fund retiree health benefits.[75] Again, highlighting the complexities of these welfare benefit funds, experts have opined on how to accelerate deductions should President Trump and Congress push through tax reform that reduces corporate tax rates.[76]

If the employer maintains a defined benefit plan, and has excess assets upon plan termination, after all plan liabilities have been paid, then those excess assets may be transferred to those retiree health benefit accounts, or to an applicable life insurance account.[77] This is generally not a taxable event to the employer or employee if all of the statutory requirements are met.

CONCLUSION

Employers are continually re-evaluating the employee benefits they offer to their workforce. The cost of hiring a good employee, and keeping him or her happy, keeps increasing, so the overall budget earmarked for benefits needs to be spent on the benefits that the employees value most. A good portion of the benefits in the current landscape include insurance products. The employer can offer insurance benefits directly to the employees, or possibly through a qualified retirement plan. If the employer expects the employees to pay a certain cost for the benefits, then

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79 Fed. Reg. 37,633 (July 2, 2014).

[72] *Longevity Annuities May Boost Retirement Security, EBRI Says*, 42 BPR 1552 (Aug. 27, 2015).

[73] §401(h).

[74] *Id.*

[75] §419 and §419A. *See also* n. 24, above.

[76] *See, e.g.,* Stephen Pavlick, *View From McDermott: Accelerating Deductions for Compensation and Benefits if Corporate Tax Rates Are Reduced*, 43 BPR 1609 (Dec. 20, 2016).

[77] §420.

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there are some tax-advantaged funding vehicles that can be offered to the employees.

Congress continues to tinker with the I.R.C. to encourage employers to offer benefits. Some of the bills introduced so far in the 115th Congress include:

- Group Term Life Insurance Increase Act of 2017 (H.R. 1012) — Currently, an employee may exclude from gross income up to $50,000 of the cost of such insurance plus any amount paid by the employee for the purchase of such insurance. The bill would increase the $50,000 limit to $375,000, and adjust such increased limit for inflation in taxable years beginning after 2018.

- Health Savings Account Expansion Act of 2017 (H.R. 247) — This bill would amend the I.R.C. to modify the requirements for health savings accounts (HSAs) to: increase the maximum contribution amounts; permit the use of HSAs to pay health insurance premiums and direct primary care expenses; repeal the restriction on using HSAs for over-the-counter medications; eliminate the requirement that a participant in an HSA be enrolled in a high deductible health care plan; and decrease the additional tax for HSA distributions not used for qualified medical expenses.

- 529 and ABLE Account Improvement Act of 2017 (H.R. 529) — Among other things, the bill would exclude from gross income a fringe benefit consisting of up to $100 per year (adjusted for inflation after 2017) of employer contributions to an employee's 529 or ABLE account. The employer contribution must be made: (1) to an account for which the designated beneficiary is the employee or a member of the employee's family, and (2) in connection with a payroll deduction contribution program established by the employer.

Based on the rocky start to this current session of Congress, especially with their failure to easily repeal and replace health care, it is extremely difficult to predict whether tax reform will actually be debated, and if so, whether insurance and other employee benefits will be affected. Income tax might not be the only reason that an employer will decide to offer employee benefits, but it generally is a major factor. Therefore, we all need to pay attention to legislative efforts to reform the Internal Revenue Code, and to communicate with our own Representatives and Senators to help ensure an environment that encourages employers to provide all benefits that their employees desire and that the employers can afford to provide.

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