

**Are employee
wellness benefits
taxable?**



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Are employee wellness benefits taxable?

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Since the implementation of the Affordable Care Act, a diverse range of health insurance and wellness products have been designed and marketed to employers as options that may lessen the impact of rising health care costs.

Wellness plans vary from simple health checks to a menu of options that include cash bonuses and tax incentives.

Until now, there has been no specific guidance on the tax implications of wellness programs; rather, conclusions are drawn based on each element of the plan.

In a recent IRS Chief Counsel Advice Memorandum, the Internal Revenue Service (IRS) clarified the extent that employer-provided wellness benefits are included in wages subject to federal income tax (FIT), federal income tax withholding (FITW), Social Security/Medicare (FICA) and federal unemployment insurance (FUTA). The ruling gives particular focus to wellness benefits provided under an IRC §125 cafeteria plan. (*TAM No. 201622031, 4-14-2016.*)

While a TAM, or information letter, may not be cited as precedent, it does provide insight into how the IRS may rule under similar facts and circumstances.

Free health screenings

Under the facts in the ruling, an employer's wellness program provided employees with free health screenings as well as other accident and health plan benefits that are excluded from taxable wages under [IRC §106](#). These wellness benefits are available to employees even if they are not enrolled in the employer's health insurance coverage plan.

The IRS held that the value of employer-provided health screenings is excluded from wages subject to FIT, FITW, FICA and FUTA.

Under [IRC §105\(b\)](#), an employee may exclude from taxable wages amounts received through employer-provided accident or health insurance if those amounts reimburse expenses incurred by the employee (including the employee's spouse, dependents and children under age 27) for personal injuries and sickness.

The value of health screenings is excluded from wages subject to FIT, FITW, FICA and FUTA even if employees are not enrolled in the employer's health insurance plan.

Tax check for your wellness program

Not taxable

- ▶ Health screenings
- ▶ Qualified medical expenses
- ▶ Coverage for a plan that provides qualified tax-free benefits
- ▶ Pretax contributions for all of the above

Taxable

- ▶ Employee cash incentives
- ▶ Nonqualified benefits such as reimbursement for athletic clubs
- ▶ Reimbursement of pretax contributions



Wellness benefits under a cafeteria plan

Under the facts in the ruling, all employees, including those who are not covered under the employer's health insurance plan, may elect to buy into the wellness program by making a pretax contribution through the employer's [IRC §125](#) plan. In addition, employees who participate in the wellness program may receive benefits that do not qualify as medical expenses under [IRC §213\(d\)](#), such as gym memberships.

The IRS held that benefits offered under an employer's wellness program that provide medical care as defined under [IRC §213\(d\)](#) are generally excluded from wages subject to FIT, FITW, FICA and FUTA under [IRC §105\(b\)](#) and [IRC §106\(a\)](#). Under [IRC §125](#), an employee's pretax contributions for coverage under the plan are also excluded from wages subject to FIT, FITW, FICA and FUTA.

- ▶ **Taxable wellness benefits.** Any other benefit provided by the wellness program that is not medical care as defined under [IRC §213\(d\)](#) is included in taxable wages subject to FIT, FITW, FICA and FUTA unless it qualifies as an exempt fringe benefit under [IRC §132](#).

For example, the value of an athletic facility operated by or on behalf of the employer and available on the employer's premises is excluded from wages subject to FIT, FITW, FICA and FUTA. However, reimbursement of an employee's cost for athletic facilities not operated by the employer is included in wages subject to FIT, FITW, FICA and FUTA. ([IRS Reg. §1.132-1\(e\)](#).)

Wellness benefits that fail to meet the definition of a qualified medical expense or that would be taxable if offered outside of the plan are included in taxable wages subject to FIT, FITW, FICA and FUTA.

Reimbursement of pretax contributions for the wellness program

Under the facts in the ruling, employees may be reimbursed for all or a portion of their cafeteria plan pretax contribution toward the cost of the wellness program.

The IRS held that any employer reimbursement of employee pretax contributions toward the cost of the wellness program is included in wages subject to FIT, FITW, FICA and FUTA.

The scheme whereby employers reimburse employees for a portion of their pretax contributions, also referred to as "double dipping," was addressed in [Rev. Rul. 2002-3](#) (2002-3 *I.R.B.* 316). In that ruling, the IRS states that if an employer makes payments to employees that reimburse a portion of the health insurance premiums paid by an [IRC §125](#) pretax deduction, such payments fail to meet the exclusions under [IRC §106\(a\)](#) and [IRC §105\(b\)](#) and are therefore included in taxable wages subject to FIT, FITW, FICA and FUTA.

Any scheme in which the employer reimburses an employee's required cafeteria plan pretax contributions will result in such reimbursement being treated as wages subject to FIT, FITW, FICA and FUTA.

Cash incentives under a wellness plan

Under the facts in the ruling, employees participating in the wellness program are eligible for cash incentives.

The IRS held that cash incentives are included in wages subject to FIT, FITW, FICA and FUTA because under [IRS Reg. §1.132-6\(c\)](#), a cash award (other than overtime meal money and local transportation fare) never qualifies as an exempt de minimis fringe benefit.

Cash incentives for employee participation in a wellness program are never excluded from taxable wages under any circumstances.

Ernst & Young LLP insights

Since the implementation of the Affordable Care Act, a diverse range of health insurance and wellness products have been designed and marketed to employers as options that may lessen the impact of rising health care costs. These products sometimes tout "tax benefits" that would likely be denied if subject to IRS scrutiny. For this reason, employers should have an employment tax advisor review health and wellness plan proposals before purchasing or implementing them.

Businesses that offer wellness programs should carefully review the various components with an eye toward those that may be included in wages for FIT, FITW, FICA and FUTA purposes. Where taxable benefits are offered under a cafeteria plan, employers should confirm that such benefits do not cause the plan to lose its tax-qualified status.

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