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Is Employer Paid the Next Evolution in Voluntary Benefits?

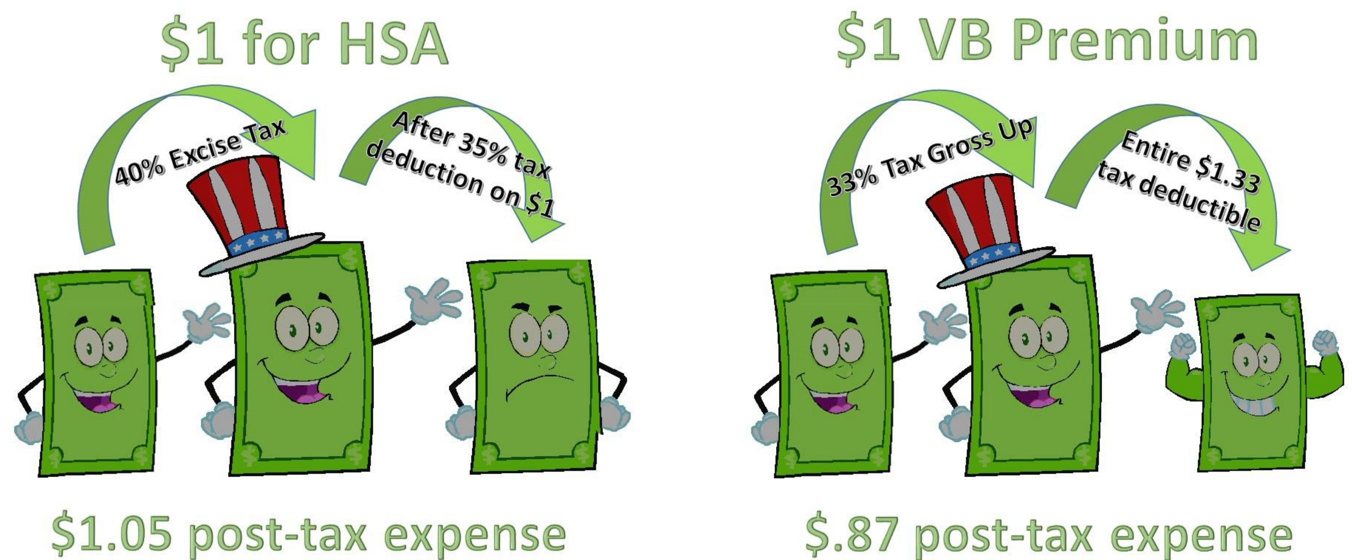
By Mark Hebert

Maybe “employer paid voluntary benefits” is a bit of a misnomer, but if you are reading the tea leaves, it looks as if the benefits we have traditionally thought of as voluntary or employee paid, may soon be making an appearance on the employer paid benefit menu. Treasury recently released initial guidance on the Excise or “Cadillac” Tax set to go into effect in 2018. While everyone should consult their own CPA for tax guidance on plan changes, one unintended consequence of this tax is that employers could save roughly 20% by using benefits dollars to purchase hospital indemnity, critical illness or accident insurance versus making a similar contribution to an employee’s HSA.

Let’s walk through the logic on this. First, the Excise Tax comes into play if the value of the plan exceeds a target threshold. If the value of the plan exceeds this threshold, then the excise tax is 40% of the amount of excess, payable by the employer for ASO plans. You can expect, therefore, that employers will work hard to stay below this threshold, raising deductibles and out of pocket maximums. The natural inclination for an employer may be to contribute a little more to the employees’ HSA to help them manage the increased risk, but the recent guidance says that any employer HSA contributions will count toward the overall value of the plan. So if the plan value is close to or above the threshold, an HSA contribution could fall into that taxable excess.

However, employer paid hospital indemnity, critical illness or accident insurance plans will not count against the value of the plan as long as the employer pays the premium with after tax dollars. The cash flow would look like this – suppose an employer wants to pay $1 for a critical illness policy. For this to be an after tax benefit, either the employee must pay taxes on that $1 or the employer must gross up the employee, covering their tax liability. Without getting into the fine points of imputed income calculations, assuming an average tax bracket of 25%, for the employer to gross up that dollar, they have to spend about $1.33.

At first glance, grossing up an employee for a CI policy ($1.33) seems close to a wash versus the 40% excise tax ($1.40), however, the key lies in the tax deductibility to the employer. The full $1.33 for the CI is deductible to the employer, so the effective spend at a 35% corporate tax rate is $0.87. The 40% excise tax, per Treasury, is not tax deductible to the employer so only $1 of the $1.40 HSA expense is deductible. The effective spend, therefore, is $1.05. The tax favorability of the CI spend saves the employer 20% versus a comparable HSA contribution. And best of all, any benefit payments to the employee are tax free!



The messaging of this strategy to employees is critical. The key talking points should focus on how the benefit is meant to help employees manage the increased out of pocket costs in the event of a catastrophic event like a critical illness, hospitalization, or accident. While employees might prefer cash in their HSA over an insurance policy, many of the carriers offer a wellness benefit on their employer paid CI, accident or HI. Every employee, therefore, would have the opportunity to earn much of that cash back by taking actions that benefit their health and wellness.

Mile 5 Benefits can help develop an effective messaging campaign to complement an employer’s overall benefit communication strategy. We can also find the carriers that offer the products that best fit within your benefits administration platform. We are dedicated to helping employers and brokers make better voluntary benefit decisions. Call us to see how we can help you!

214-584-6560, mark.hebert@mile5benefits.com, www.mile5benefits.com