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Employee Benefits and Executive Compensation

Money and Trinkets Provided for Wellness

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More and more employers and insurance companies are providing incentives and rewards to employees and their covered dependents to encourage participation in wellness programs—programs designed to improve an individual's overall health and well-being, and to avoid and even treat, chronic health conditions. While there are many laws governing wellness programs, this article focuses on the often-overlooked federal income tax implications to employers and employees. Note that other federal or state laws affecting wellness program and federal excise tax implications to employers, which should not be forgotten when designing and operating a wellness program, are beyond the scope of this article.

Examples of wellness incentives include:

- Cash incentives and gift cards (e.g., a $100 cash reward for taking a health risk assessment)
- Paying all or part of the cost of health club or gym memberships and fitness classes
- On-site workout facilities
- Healthy snacks, water bottles, T-shirts, etc.
- Movie or sports event tickets
- Raffles and prizes
- Awarding large fitness equipment (e.g., treadmill or a bicycle)
- Awarding additional paid time off or permitting exercise during work time
- Health seminars or classes
- Discounts on the employer's goods or services
- Reductions in monthly or annual health care premiums or contributions (e.g., a $100 premium reduction per month)
- Additional employer contributions to health care flexible spending, health reimbursement accounts, or health savings accounts
- Waiver of all or part of deductibles or coinsurance for wellness-related medical care (e.g., waiving a copayment for completing a physical exam)
- No-cost participation or reimbursements for health-related programs (e.g., smoking-cessation or weight-loss programs)

Taxation of Wellness Incentives

Because wellness incentives are often considered nominal, many employers overlook the tax implications of wellness incentives that they supply or fail to make the tax implications clear to employees when they communicate the wellness program initiative, creating an unwelcome surprise for employees who may not be expecting to pay tax on a wellness incentive.

Wellness incentives are taxed like all other "rewards" and there is no exemption under current tax law that excludes from income the incentives paid through wellness programs. In general, wellness incentives are subject to the same tax rules as all other benefits—the value of a reward is treated as taxable wages and subject to payroll taxes (i.e., Social Security and Medicare taxes and federal and state income tax withholding) unless a specific exemption allows the reward to be provided on a tax-free basis.

In most cases, wellness incentives need to qualify as an employer-provided health benefit or "de minimis" fringe benefit to be provided on a tax-free basis.

Employer-Provided Health Benefits

Amounts paid by employers or received by employees for medical care under an employer-provided health plan are excluded from employees' gross income under Internal Revenue Code sections 105 and 106. For this purpose, "medical care" generally means amounts paid for either (1) the diagnosis, cure, mitigation, treatment, or prevention of disease or (2) the purpose of affecting any structure or function of the body.

These exclusions permit an employer to provide non-taxable wellness incentives to employees such as a reduction to the employee's monthly premium or contribution and a reduction on the plan's annual deductible (assuming that HIPAA and other applicable requirements are also met). In addition, the Code permits an employer to contribute dollars to an employee's health flexible spending account (FSA), health reimbursement account (HRA), or health savings account (HSA) on a tax-free basis when an employee successfully completes a wellness program (assuming certain requirements are met). Caution is advised before making employer contributions to FSAs, HRAs, and HSAs—generally, these contributions are nontaxable unless they are discriminatory, but these contributions pose other issues as well.

It is worth pointing out that, this exclusion only applies to amounts provided to the employee for medical care. Some wellness benefits will qualify as medical care because they serve a diagnostic or preventive function (e.g., high blood pressure screenings or vaccinations). Expenses that are merely beneficial to an individual's general health or wellbeing are not expenses for medical care under the Code and would likely be taxable. For example, if the employer reimbursed employees for gym memberships, the reimbursement would typically be includable in the employees' income as a taxable benefit because there is no specific Code section supporting an exclusion. Gym memberships do not generally constitute medical care under Code section 213 (unless the gym membership is prescribed by a doctor to treat a specific disease) and receiving a cash reimbursement for a gym membership would not qualify as a nontaxable benefit under Code section 132. However, if the employer provides an on-site athletic facility for its employees, it may not be taxable, as discussed below.

Very Minimal Benefits and Not-So-Minimal Benefits

The value of any property or services provided to an employee that has so little value that accounting for it would be unreasonable or administratively impracticable is not included in employee compensation and is not taxable. In addition to the value of the

benefit, frequency must also be considered in determining if a benefit is de minimis. Examples of wellness incentives that are de minimis benefits include: providing an occasional movie or sports event ticket, water bottles, T-shirts, healthy snacks, and offering health seminars and classes at the worksite. Raffle items and prizes may qualify as de minimis fringe benefits, depending on the item. However, large-dollar items (e.g., iPads or large fitness equipment) will never qualify as de minimis fringe benefits, so someone has to keep track of the winners and transmit that information to the employer's payroll for inclusion in the employee's wages.

Unfortunately, there is no bright-line dollar amount as to what qualifies as de minimis. Sports event tickets have risen in price since the adoption of the U.S. Treasury Regulations that list sports event tickets as an example of a de minimis item. It wouldn't be surprising if the IRS's position today is that the only sports tickets that are de minimis are tickets to the local minor league baseball team. The bottom line is that employers must use their judgment in deciding whether a particular item is excludable from employee income as a de minimis fringe benefit. Code section 132(e); Treas. Reg. section 1.132-6.

Reminder About Cash and Gift Cards

Cash incentives, including cash reimbursements and cash equivalents (like gift cards or a similar item that is readily converted to cash) are always taxable. As described above, non-cash incentives might be tax free if they are "de minimis" fringe benefits. Cash is never a de minimis fringe benefit, no matter how little (except in the limited cases of overtime meal money or local transportation that is required because of overtime work or security concerns). Accordingly, if the employer offered cash or a gift card to any employee who completed a health risk assessment, the cash amount or gift card value would be reported with the employee's wages and be subject to payroll taxes. In addition, if an employer reimburses the cost of the employee's participation in a health or wellness program that does not qualify as medical care, the reimbursement would be taxable income to the employee. If a health or wellness program qualifies as medical care, however, a cash reimbursement properly provided to an employer under the employer's health plan (including an HRA, FSA, or HSA) will not be taxable to the employee (as discussed above under Employer Provided Health Benefits). Treas. Reg. section 1.132-6(c).

On-Site Athletic Facilities

Unlike gym membership reimbursements, if an employer allows its employees and their dependents to use a gym or other athletic facility (e.g., a swimming pool, tennis courts, or golf course) on the employer's premises, the value is not included in employee compensation and is not taxable. Code section 132(j)(4). The athletic facilities must be on property owned or leased by the employer, but do not have to be on its business premises. The athletic facility must principally be for use by employees, their spouses, and dependent children during the entire year. This exclusion does not apply if the athletic facility is available to the general public through membership sales, rental, or similar arrangements or if the facilities are for residential use (such as a resort with accompanying athletic facilities). Treas. Reg. section 1.132-1(e)(1) and (2).

Qualified Employee Discounts

Not every wellness incentive would qualify as a non-taxable fringe benefit, but an employer could offer fringe benefits as part of a wellness program. For example, an employer that is a retail grocer might offer rewards in the form of employee discounts on healthy foods, or an employer that operates a gym or other athletic facility may be

able to offer their employees a discount under the qualified employee discount rules. The exclusion for qualified employee discounts generally applies to discounts on merchandise or services an employer offers for sale to current or retired employees on a nondiscriminatory basis. Code section 132(c); Treas. Reg. section 1.132-3.

Free Time

Employers may also award additional paid time-off or permit employees to exercise or attend health classes during work hours. Nevertheless, any wages (i.e., cash) paid with respect to additional "free time" continue to be taxable to the employee and subject to payroll taxes.

Reporting Taxable Wellness Incentives

Employers that offer taxable wellness incentives should remember that they must (1) report these amounts on each employee's Form W-2 and (2) withhold payroll taxes on these amounts, even if a third party (i.e., a group health plan insurer or health care provider) provides the actual benefits. Generally, employers are considered the provider of fringe benefits even if a third party provides the actual benefits and therefore must still satisfy any related reporting and withholding requirements.

In addition, employers may be responsible for payroll taxes if the wellness incentives are provided without proper tax withholding.

Are Wellness Incentive Included in Employer-Sponsored Group Health Plan Coverage Reportable on Form W-2?

Under the Affordable Care Act, employers are required to report the cost of employer-sponsored health coverage on Form W-2s issued to employees. This information is informational only and will not affect the amount includible in income or the amount reported in any other box on Form W-2.

The IRS has indicated that coverage under a wellness program is included in the cost of coverage to the extent that the program is a group health plan (generally, if it provides medical benefits). However, if an employer does not charge a COBRA premium for continuation coverage under the wellness program (or the employer is not subject to COBRA), the cost of coverage is not required to be reported.