PUBLICATION

Health Insurance Rebates May Be Headache for Employers

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One of the new requirements of the Public Health Service Act (PHSA) is that insurance companies must report and rebate profits that exceed permissible amounts under medical loss ratio (MLR) rules. Regulations recently released by the Department of Health and Human Services (HHS), Centers for Medicare & Medicaid Services, implementing these new rules will impact many employers with fully-insured group health plans. Any required rebate must generally be paid by the insurer to, or applied for the benefit of, the employee, the employer, or some combination thereof.

Entitlement and Application of Rebates

Employer-sponsored group health plans are generally subject to the Employee Retirement Income Security Act of 1974, as amended (ERISA), with limited exceptions. The U. S. Department of Labor (DOL), which regulates and enforces ERISA, has made clear that rebates an employer receives may, under some circumstances, be treated in whole or in part as ERISA plan assets. In Technical Release 2011-04, the DOL rules focus primarily on the identity of the policyholder, the terms of the policy, and the source(s) of premiums paid under the policy to determine the employer's and the plan's entitlement to part or all of a rebate. To the extent a rebate is treated as an ERISA plan asset under these rules, that amount must be applied solely for the benefit of plan participants, rather than to benefit the employer or others. This means that employers receiving these rebates should consult with counsel on the entitlement to, and permissible uses of, the rebates. The HHS regulations also provide guidance on entitlement and application of rebates for non-ERISA plans, such as governmental or church plans.

Taxation of Rebates

There is no current direct guidance from the IRS, Treasury Department, or to our knowledge state regulatory agencies regarding the tax treatment of any rebate paid to an employer or a health plan participant. However, under ordinary principles of taxation, any rebate retained by a taxable employer which had previously deducted the underlying premium payment should be included in the employer's income. For individuals who receive cash rebates, the issue of taxation becomes somewhat more complex. A cash rebate paid to an employee should be taxable, while the same rebate used by the insurance company to reduce future premiums may not be taxable. As a result, employers who divide and pay rebates to employees may face reporting and withholding issues.

Conclusion

Because of the complexity of the issues presented by ERISA and the DOL guidance relating to determinations of entitlement to MLR rebates and the permissible application of rebates which are plan assets, as well as the taxability of a rebate amount under varying circumstances, employers who receive any such rebates are encouraged to consult with their advisor.

Should you wish to discuss any tax aspect of the anticipated MLR rebate requirements, please contact any attorney in the Firm's Tax or Health Departments.