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Memorandum

To: Rich McLaughlin, General Manager
GOLD MOUNTAIN COMMUNITY SERVICES DISTRICT

From: Allison M. De Tal, Of Counsel
BEST BEST & KRIEGER LLP

Date: August 19, 2021

Re: Initial Review of Benefits Offered to Employees

RECOMMENDATIONS

Gold Mountain Community Services District ("District") should adopt a benefits policy that outlines the benefits offered to its employees (e.g., types of plans, amount of District contribution towards benefits, etc.). We recommend that the District adopt a revised version of Policy Number 2150 that incorporates this information and the circumstances when an employee can change his or her election to participate in benefits or receive additional compensation (e.g., annually through open enrollment). A revision to Policy Number 2150, rather than a new policy, is the best approach because employee's receive additional compensation if they elect to decline voluntary benefits, and benefits represent a component of compensation. The current language in Policy Number 2150 can also be streamlined during the amendment process. Further, we recommend that the District adopt an election form where employees elect to participate in SDRMA benefits or receive additional taxable compensation. We would be happy to work with you to prepare an amendment of Policy Number 2150 and the election form.

To the extent that the District requires employee contributions to fund voluntary benefits, it must have a plan in place that complies with Internal Revenue Code ("Code") Section 125 and the underlying regulations in order for such contributions to be made on a pre-tax basis. Further, the adoption of a Code Section 125 plan also avoids the application of the constructive receipt doctrine which would trigger additional taxable compensation even for employees who do not elect to receive additional compensation in lieu of benefits. We would be happy to prepare a Code Section 125 plan for the District, and provide advice regarding the administration of the plan.

STATEMENT OF FACTS

The District currently has six employees (four full-time and two part-time), and all full-time employees are eligible for District provided benefits or can elect to receive a 30% increase in their hourly compensation in lieu of "voluntary benefits."[1] For example, the maximum

[1] Policy 2150, Compensation Schedule A (Updated 2015).

compensation rates for the General Manager with benefits and without benefits are $42.22 and $54.89 per hour, respectively. We understand that the term "voluntary benefits" refers to group medical, dental and/or vision benefits, medical reimbursement programs, and related programs offered by the District through SDRMA. Of the District's current four full-time employees, two participate in the SDRMA benefits offered by the District and the other two have opted to have a 30% increase in their hourly compensation. The District, however, does not have a benefits policy that outlines any details associated with the benefits offered to employees.

ANALYSIS

1. Additional Compensation In Lieu of Benefits

There are a variety of rules in the Affordable Care Act ("ACA") that are designed to require that employers provide health coverage to their employees. For example, "applicable large employers" can be subject to substantial penalties if they: (1) fail to offer health coverage to their full-time employees and an employee receives a premium tax credit to purchase coverage through a state sponsored exchange; or (2) offer coverage, but it fails to meet the "affordability" or "minimum value" requirements, and an employee receives a premium tax credit for coverage offered through a state sponsored exchange.[2] These penalties, however, only apply to "applicable large employers." The term "applicable large employer" is generally defined as an employer that has an average of at least 50 full-time and full-time equivalent employees during the preceding calendar year.[3] Accordingly, given the number of individuals employed by the District, it is not considered an "applicable large employer" and will not be subject to these penalties.

Though the District will not be subject to the penalties discussed above, there are a number of general provisions in the ACA which make it prudent for employers to require an employee's proof of participation in another employer's group health plan (e.g., a spouse's employer's plan) in order to allow employees receive cash in lieu of group health coverage. These general ACA provisions are broadly referred to as "market reforms." Such reforms include the prohibition on annual dollar limitations[4] and the requirement that plans offer certain preventative services.[5] There are rules that prohibit employers from offering certain types of coverage that do not meet these requirements and effectively "dump" employees into the individual (i.e., Covered California) market. These rules require that certain employer provided group health plans (e.g., HRAs) be integrated with another compliant group health plan. These rules are enforced through the imposition of excise taxes (generally $100 per day for each individual that is out of compliance).[6]

[2] Code Section 4980H.
[3] Treasury Regulation Section 54.4980H-1(a)(4).
[4] Public Health Service Act ("PHSA") Section 2711.
[5] PHSA Section 2713.
[6] *See* Code Section 4980D.

IRS Notice 2013-54 provides that "[a]n employer payment plan . . . does not include an employer-sponsored arrangement under which an employee may choose either cash or an after-tax amount to be applied toward health coverage. Individual employers may establish payroll practices of forwarding post-tax employee wages to a health insurance issuer at the direction of an employee without establishing a group health plan . . . ." However, IRS Notice 2015-17 notes that this position was based on Revenue Ruling 61-146 which pre-dates the ACA. IRS Notice 2015-17 makes it clear that employer provided cash reimbursements to purchase insurance through Covered California (i.e., the individual policy market) is actually a type of group health plan that must satisfy the ACA's market reforms—"without regard to whether the employer treats the money as pre-tax or post-tax to the employee." Further, "[s]uch employer health care arrangements cannot be integrated with individual market policies to satisfy the market reforms and, therefore, will fail to satisfy PHS Act [Sections] 2711 (annual limit prohibition) and 2713 (requirement to provide cost-free preventive services) among other provisions."

As a result, we strongly recommend that the District require proof of other group health insurance (e.g., through another employer such as the employer's spouse) in order to avoid having its cash in lieu arrangement construed as reimbursing an employee (pre-tax or post-tax) for coverage obtained on the individual market and having penalties imposed.

2. Constructive Receipt of Income

Cash basis taxpayers (i.e., nearly all individual taxpayers) must include amounts in income during the year such amounts are actually or constructively received.[7] Income is constructively received "in the taxable year during which it is credited to [the taxpayer's] account, set apart for him, or otherwise made available so that he may draw upon it at any time, or so that he could have drawn upon it during the taxable year if notice of intention to withdraw had been given."[8] Income, however, "is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions."[9] The cash in lieu of benefits program will need to be structured in a manner that does not cause the constructive receipt of income. If it is not structured in this manner, it will be as if all employees have opted to receive additional compensation in lieu of benefits—even if this election is not made. One method to avoid the constructive receipt of income is to offer the benefit through a plan that complies with Code Section 125—discussed below.

3. Code Section 125 Plan

A Code Section 125 plan allows an employer to give employees the option of choosing two or more benefits of cash and qualified benefits.[10] There are a number of qualified benefits that can be offered under a cafeteria plan, including health plan coverage and health FSAs.

[7] Code Section 451(a).
[8] Treasury Regulation Section 1.451-2(a)
[9] *Id.*
[10] Code Section 125(d)(1).

In addition to avoiding the application of the constructive receipt doctrine to the compensation received in lieu of benefits, employees cannot contribute towards the cost of their benefits on a pre-tax basis unless the employer has adopted a Code Section 125 plan.