35th Annual

Tax Symposium

CURRENT HOT TOPICS IN HEALTH AND WELFARE BENEFITS

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AN OVERVIEW OF THE CURRENT STATE OF AFFAIRS

HOW BENEFITS AND TAXES CONNECT

- **Employee benefits are the largest type of non-cash pay and involve many tax rules in the Internal Revenue Code.**
- **Key Code sections for CPAs and tax professionals:**
  - **Tax-free income rules:** Sections 105, 106, 125, 129, and 132
  - **Deduction and contribution rules:** Sections 162, 213, and 223
  - **Penalty taxes:** Sections 4980B (COBRA), 4980D (health plan rules), and 4980H (employer coverage)
  - **Information reporting:** Sections 6055 and 6056; Forms 1094-C, 1095-C, and W-2
  - **Tax-advantaged accounts:** Section 223 (HSAs), Section 125 (cafeteria plans), and Section 105(b)/(h)

THE RULES YOU NEED TO KNOW

1	2	3
Interlocking federal laws: Tax law works together with ERISA, COBRA, HIPAA, ACA, Mental Health Parity, GINA, ADA, and FMLA	**Three regulatory agencies:** Treasury/IRS, Department of Labor, and HHS	**State overlay:** State health insurance mandates, paid leave taxes, and privacy laws add further requirements

WHY THIS MATTERS FOR YOUR PRACTICE

- **Payroll tax issues:** Pre-tax elections, Social Security/Medicare treatment of benefits, state tax differences
- **Client service opportunities:** Year-end planning, M&A reviews, penalty relief, plan design improvements
- **Watch out for:** IRS Letter 226J penalty notices, penalty taxes, reporting fines, liability for related companies
- **Working with benefits lawyers:** Knowing when to refer clients and what questions to ask

IRS PROPOSED REGULATIONS AND DEPENDENT CARE ACCOUNTS

DEPENDENT CARE ACCOUNTS (SECTION 129): ANNUAL LIMITS

$7,500

Annual limit under the CAA 2026

($3,750 if married filing separately)

$5,000

Prior annual limit

($2,500 if married filing separately)

Nondiscrimination testing still applies:
plans must pass tests to ensure benefits aren't tilted toward owners and highly paid employees.

IRS PROPOSED REGULATIONS UNDER SECTIONS 128 AND 129

Significantly ease the nondiscrimination testing rules for dependent care FSAs

55% average benefits test:

The average benefits provided to non-highly compensated employees must be at least 55% of the average benefits provided to highly compensated employees

Key rule change:

The average is now calculated using only employees who receive more than $0 in benefits during the plan year (whether through salary reduction or otherwise)

IMPACT ON EMPLOYERS AND EMPLOYEES

- **Reliance:** Employers may rely on the proposed regulations beginning in 2026
- **Practical impact:** Most employers can pass the 55% average benefits test far more easily
- **Full use of the new limit:** Employers can take full advantage of the increased $7,500 DC FSA limit under the CAA 2026
- **Coordination:** Dependent care FSA exclusions must be coordinated with the dependent care tax credit



WEIGHT LOSS DRUGS (GLP-1S) AND SECONDARY 125 PLANS

WEIGHT LOSS DRUGS (GLP-1S) AND HEALTH PLAN COVERAGE

- **Coverage:** Covering weight loss drugs like Ozempic/Wegovy under group health plans
- **Cost control strategies:** Prior authorization, step therapy, specialty pharmacy
- **ACA preventive care:** USPSTF obesity screening recommendation considerations
- **Mental health parity:** Possible issues if eating disorders are covered as mental health conditions



SECONDARY 125 PLANS: OVERVIEW

- **What they are:** A second cafeteria plan arrangement layered on top of existing major medical coverage, often marketed as "supplemental," "wellness," or "SIMRP" plans by third-party promoters
- **Typical structure:** Pre-tax salary reduction under Section 125 paired with a self-insured medical reimbursement plan, fixed indemnity policy, or wellness program paying cash benefits back to the employee
- **The core issue:** Reliance on Section 125 for pre-tax premiums and Sections 105/106 to exclude the payments back, a combination the IRS disputes

SECONDARY 125 PLANS: HOW THEY WORK

1

Employers:
Adopt a plan document and vendor contract; promoters often charge a per-employee fee or a share of claimed FICA savings

2

Employees:
Elect a large pre-tax salary reduction to pay the secondary plan “premium”

3

Benefits:
Telehealth, health coaching, wellness services, and fixed cash payments triggered by minimal activities (e.g., a health survey or coaching call)

4

Claimed savings:
Taxable wages and FICA drop, while the “tax-free” benefit returns most of the reduction, leaving take-home pay roughly unchanged

THE CREATIVE SIDE

- **Wellness indemnity designs:** Fixed payments for wellness activities labeled "medical care" but untied to incurred medical expenses
- **SIMRPs:** Funded with pre-tax premiums and returning nearly the full premium through recurring benefit payments
- **Refund and rider features:** Premium "refunds" or "advances" paid regardless of claims; fixed indemnity riders sold as supplements



Red-flag marketing:

"Zero net cost," "guaranteed FICA savings," "IRS-approved," or opinion letters from promoter counsel

POTENTIAL FOR ABUSE: IRS GUIDANCE

- **Chief Counsel Advice:** CCA 201622031 and 201703013 treat fixed wellness payments as taxable wages subject to withholding and FICA; CCA 202323006 (2023) reaffirmed this for fixed indemnity policies
- **Underlying authorities:** Section 105(b) and Treas. Reg. §1.105-2 exclude only incurred, substantiated medical expenses; Rev. Rul. 2002-3; 2007 proposed Section 125 regulations
- **Enforcement posture:** IRS has warned the public about promoters; expect employment tax audits focused on Forms 941 and W-2

POTENTIAL FOR ABUSE: RISKS AND PRACTICAL STEPS

Employer risks:

Back FICA and income tax withholding, interest, and penalties, including the Section 6672 trust fund recovery penalty; possible cafeteria plan disqualification; ERISA, COBRA, and plan document exposure

Employee risks:

Underreported wage income, amended returns, and reduced Social Security earnings credits

Practical tip: Obtain the plan document, policy, and claims data; confirm benefits are tied to incurred medical expenses; treat unsubstantiated payments as wages; consider unwinding and voluntary correction

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QUESTIONS

Submit questions for presenters

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THANK YOU



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