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Double-Dipping is Always a No-No Gallagher

A variety of reimbursement arrangements are marketed to employers that purportedly allow them to reimburse employees, on a supposed tax-free basis, for health insurance contributions *paid by the employees on a pre-tax basis*. While the specific structure of these programs varies, in general, they are promoted as resulting in an excludable employer reimbursement for coverage that has already been excluded from an employee's income as a pre-tax cafeteria plan contribution. These programs result in the employer and the employee "double-dipping" from the Internal Revenue Code (IRC) Section 106 exclusion.

Background on Health Coverage Exclusion

Most employers pay for part of the cost of accident and health insurance for employees while allowing their employees to fund the rest of the cost on a pre-tax basis through a cafeteria plan. Such payments generally are not taxable to employees for federal income tax purposes and are excludable by employees and employers for employment tax purposes.

- Section 105 generally provides that employees are receiving tax-free benefits when their employers reimburse their medical expenses.
- Section 106 provides that if an employer pays an employee's premiums, then those payments are not included in the employee's gross income and are not subject to income taxes.
- Section 125 states that if an employee chooses to pay for health insurance coverage on a pre-tax basis rather than receive cash through a cafeteria plan, then the amounts paid for qualified benefits do not count as gross income under Section 106.
- Sections 3121 and 3306 of the IRC say amounts excluded from gross income under Sections 105 and 106 are not subject to FICA or FUTA taxes.

In [Revenue Ruling 61-146](#), the IRS ruled that an employer may reimburse employees for accident or health insurance policies of the employee's own choosing, and that such reimbursement can qualify for the exclusion for employer-provided coverage under Code Section 106, so long as (a) the employer has an accident or health plan under which it makes the reimbursements; and (b) the employer requires the employee to

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show that the amounts reimbursed were actually spent by the employee for insurance coverage.

IRS Says No to Double-Dipping

While there is no question that health coverage generally can be excluded from income when paid through pre-tax salary reduction (under IRC Sections 106 and 125) or when reimbursed to employees (IRC Sections 105, 106, and 125 and Revenue Ruling 61-146), the prohibited aspect of these programs arises because of the allegedly tax-free reimbursement of the already-excluded amounts. Even though the specific structure of double-dipping programs may vary, employers must understand that employers and employees can only take a tax deduction for a health care premium *one time*. The tax deduction may be taken by either the employer or the employee, but not both.

The IRS has attempted to clarify its position and highlight the issues with such programs in numerous Revenue Rulings and Chief Counsel Memoranda in the early 2000s, late 2010s, and again in the 2020s. In [Revenue Ruling 2002-80](#), the IRS struck down two double-dipping arrangements: one that purported to provide tax-free “advance reimbursements” of potential future unreimbursed medical expenses and another under which employees received “loans” that were either offset by unreimbursed medical expenses or forgiven.

The goal of the two arrangements was to decrease taxable wages and increase FICA savings for the employee and employer by increasing salary reduction amounts, while making employees whole through tax-free reimbursement. These arrangements attempted to obtain the Section 105 income exclusion by conditioning the tax-free portion of the reimbursement on the employee’s uninsured medical expenses. However, the IRS explained that for an amount to be excluded under Section 105, it must be received under an accident or health plan, and payment must be made specifically to reimburse the employee for medical care expenses. If the employee is entitled to an amount regardless of whether he or she incurs a medical expense, then the IRC Section 105 exclusion does not apply, and all payments from the arrangement are included in gross income.

The IRS found that the up-front payments received by employees under the advance reimbursement arrangement were triggered merely by participating in the plan and not by incurring a medical expense as required by Section 105 (employees were entitled to the amounts even if they had not incurred any medical expenses). The fact that some

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advance reimbursements were applied to medical expenses incurred during the year was irrelevant, since employees were not required to incur expenses to receive the advance reimbursement. Thus, the advance reimbursements were considered to be gross income subject to income and employment taxes.

Using the same analysis, the IRS found that the loan arrangement was not an accident or health plan, since employees were entitled to the loan amounts regardless of whether they incurred medical expenses. Moreover, the IRS dismissed the employer's characterization of the arrangement as a "loan." Under the IRC, a loan is not included in the gross income of the individual because there is a corresponding obligation to pay the loan back. However, employees were not required to repay their loans if no medical expenses were submitted; instead, the employer forgave any excess of the loan over medical expenses.

The IRS further clarified its position on double-dipping programs in 2023. In [CCA 202323006](#), issued in June 2023, the IRS focused on payments made when there are no unreimbursed medical expenses related to a payment, specifically from fixed indemnity policies paid with pre-tax salary reductions through a cafeteria plan. This CCA established that wellness payments made from a fixed indemnity policy, paid with employee pre-tax salary reductions under Section 125, are includable in employees' gross income if the employee has no **unreimbursed** medical expenses related to the payment.

DOL Weighs in on Tax Avoidance Scheme

As demonstrated by an important court case, it is not just the IRS investigating these arrangements. In this case, a promoter designed a program that was described as a supplemental benefit plan to be used to reimburse employees for medical expenses such as copays and deductibles. In fact, the arrangement was simply another variation of the classic "double-dip" scheme. The program was marketed to unrelated employers and, according to a Department of Labor (DOL) [news release](#), was used by 350 employers before being shut down. The DOL, in conjunction with other federal agencies, investigated this program and successfully prosecuted the program's promoter for operating a fraudulent multiple employer welfare arrangement (MEWA). The DOL does not handle tax issues. However, in its news release on this case the DOL commented that "...[the promoters] caused at least \$20,000,000 in federal FICA taxes as well as a "significant" amount of personal income taxes to be underpaid, amounts for which the employer-clients and employee-participants are now individually

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responsible.” Although the promoters were indicted, the news release makes clear that the employer and employees who fell victim to the double-dipping scheme are still responsible for the payment of all unpaid taxes that resulted from the program.

Final Thoughts

No matter the exact structure of the arrangement, employers must be mindful that double-dipping programs are not permitted under IRS rules.

If you are being offered such a program, then you must remember if a new tax-saving arrangement “sounds too good to be true,” it probably is. If you do not know if an arrangement constitutes a prohibited double-dipping program, consult with your tax counsel. Employers are ultimately responsible for tax reporting and withholding with regard to benefits that they provide to their employees.

The intent of this article is to provide general information on employee benefit issues. It should not be construed as legal advice and, as with any interpretation of law, plan sponsors should seek proper legal advice for application of these rules to their plans.