

Publications

IRS Chief Counsel Advice Says Wellness Indemnity Payments Are Taxable If No Unreimbursed Medical Expenses Related to the Payment

ATTORNEYS & PROFESSIONALS

Kathryn Bjornstad Amin

kamin@groom.com

202-861-2604

David Block

dblock@groom.com

202-861-5427

Christine Keller

ckeller@groom.com

202-861-9371

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On June 8, 2023, the IRS released [Chief Counsel Advice 202323006 \(the “CCA”\)](#) addressing the tax treatment of wellness indemnity payments made by employer-funded fixed indemnity insurance policies. The CCA generally provides that if an employee receives a wellness indemnity payment under a fixed indemnity health insurance policy and the employee paid the premiums by a pre-tax salary reduction through a cafeteria plan, the payment will be included in the employee’s gross income as wages subject to FICA, FUTA, and Federal income tax withholding to the extent the employee does not have any unreimbursed out-of-pocket medical expenses related to the payment.

This is the fourth CCA the IRS has released on this topic. The IRS previously released CCAs 201622031, 201703013, and 201719025, all of which addressed the taxability of wellness benefits and fixed-indemnity payments.

Facts

In the example discussed in the CCA, an employer provided its employees the ability to enroll in a fixed indemnity health insurance policy intended to supplement the employer’s group health coverage. Enrolled employees paid the fixed indemnity policy’s \$1,200 monthly premiums with a pre-tax salary reduction through a cafeteria plan. The fixed indemnity health insurance policy provided the following benefits to participants:

- A payment of \$1,000 (i.e., a wellness indemnity benefit) if the employee participated in certain health or wellness activities (including obtaining preventive care, such as vaccinations for which the employee had coverage under a separate comprehensive health plan), limited to one payment per month;

- Wellness counseling, nutrition counseling, and telehealth benefits at no additional cost. The employee was responsible for any costs associated with receiving any health-related activity, although in many cases those costs were covered by other insurance or provided at no cost to the employee; and.
- A benefit for each day the employee was hospitalized.

The wellness benefits were all paid from the insurance company to the employer, who then paid the wellness benefits to the employees via payroll.

IRS Analysis

The IRS specifically focused on the taxability of the wellness indemnity benefit and concluded that the wellness indemnity benefit was taxable income to the employee and subject to FICA, FUTA, and Federal income tax withholding if the employee had no unreimbursed out-of-pocket medical expense related to the payment. The IRS noted the following in reaching its conclusion:

- The employee did not qualify for the tax exclusion under Code section 105(b) because the employee (1) was entitled to receive the wellness indemnity benefit regardless of whether he/she incurred medical expenses and (2) did not have any unreimbursed medical expenses as a result of the activity that triggered the payment because either the payment did not cost the employee anything or the employee was reimbursed for the cost by other insurance coverage.
- The employer provided the wellness indemnity benefit to the employee in connection with the employee's employment, and thus the benefit was remuneration treated as "wages" subject to FICA, FUTA, and Federal income tax withholding. The IRS reasoned that:
 - The wellness indemnity benefit did not qualify for any exclusion from Federal income tax withholding because the payments were not sick pay (because the payments were not dependent upon an absence from work), and there were no other applicable exceptions from the definition of wages subject to Federal income tax withholding under Code section 3401(a) that could have applied.
 - The wellness indemnity benefit did not qualify for any exclusions from the definition of "wages" under FICA because:
 - although the payments may have been made on account of sickness or accident disability, they were not received under a workers compensation law (making the exclusion under Code section 3121(a)(2)(A) inapplicable).
 - the payments were not made on account of medical or hospitalization expenses in connection with sickness or accident disability (making the exclusion under Code section 3121(a)(2)(B) inapplicable).
 - the payments are includable in the employee's gross income (making the exclusion under Temp. Treas. Reg. sec. 32.1(d)(1) inapplicable).
 - The wellness indemnity benefit did not qualify for the Code section 3306(b)(2)(A) exclusion from FUTA because, although the payments may have been made on account of sickness or accident disability, they were not received under a workers compensation law.

Conclusion

Although a CCA is not formal guidance that may be used or cited as precedent, it does provide an indication of the IRS's views on an issue. Whether the IRS will publish formal guidance on this topic remains to be seen. However, based on the fact that four CCAs were issued on this topic, this does seem to be an area of continued IRS focus.