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In this Issue:

IRS Proposes to "Clarify" Tax Treatment of Hospital Indemnity and Specified Disease Coverages

Employers would no longer be permitted to offer hospital indemnity, specified disease, and other "supplemental" coverages on a pre-tax basis under proposed regulations published by the IRS on July 12, 2023. In order to avoid benefit payments from these plans being treated as taxable income and wages for employment tax purposes, the proposed regulations would instead require that employers make employees pay the premiums on an after-tax basis. The proposed regulations also would change the criteria for certain plans to qualify as "excepted benefits," and thus be exempt from otherwise applicable group health plan requirements.

Summary of Proposed Tax Rule Change

The issue is whether and how the Code section 105(b) gross income exclusion applies to these supplemental coverages, which typically pay a fixed-amount to covered employees when they are hospitalized, diagnosed with a specified condition or disease, or experience some other triggering event. The benefit payments may be used to reimburse out-of-pocket medical expenses, but they do not have to be. In fact, the plans pay benefits regardless of whether covered employees actually incur any out-of-pocket medical expenses. And that, according to the proposed regulations, is the problem.

Basically, the Code section 105(b) gross income exclusion applies to reimbursements for medical care expenses. However, current regulations include conflicting language about whether the payments have to be limited just to the amount needed to reimburse medical care expenses, or whether the payments can exceed incurred medical expenses and the excess be treated as taxable income. The current regulations also do not explicitly require that the medical care expenses be substantiated for Code section 105(b) to apply.

The proposed regulations would add language specifically stating that "section 105(b) does not apply to amounts that the taxpayer would be entitled to receive irrespective of the amount of medical care expenses the taxpayer incurs or that are paid to reimburse the taxpayer for incurred section 213(d) medical care expenses if the medical care expenses have not been substantiated by the plan."

Changes to "Excepted Benefit" Criteria

A separate part of the proposed regulations, issued jointly by the Departments of Treasury, Labor, and Health and Human Services, would enhance the requirements for hospital indemnity and other fixed indemnity plans to qualify as "excepted benefits." Plans that are "excepted benefits" are not required to comply with the ACA's group health plan mandates – such as the bans on preexisting condition exclusions and annual and lifetime dollar limits – or other group health plan requirements.

Unlike the proposed tax changes discussed above, which would apply to hospital indemnity and specified disease plans, the proposed changes to the "excepted benefit" requirements would apply only to hospital indemnity and other fixed indemnity plans. There are no proposed changes to the rules for specified disease plans to be "excepted benefits."

Basically, under current rules, fixed indemnity plans must meet the following criteria to be "excepted benefits":

- They must pay a fixed dollar amount per day (or other period) of hospitalization or illness, regardless of the amount of expenses incurred;
- The benefits must be provided under a separate policy, certificate, or contract of insurance;
- There is no coordination between the provision of the benefits and an exclusion of benefits under another group health plan maintained by the same plan sponsor; and
- The benefits are paid with respect to an event without regard to whether benefits are provided with respect to the event under any group health plan maintained by the plan sponsor.

In addition to these requirements, the proposed regulations would add new requirements for fixed indemnity plans (including hospital indemnity plans) to qualify as excepted benefits. Specifically, the basis for determining the fixed dollar amount could not be:

- the actual or estimated amount of expenses incurred,
- per services or per items received,
- the severity of the illness or injury, or
- any other characteristics particular to a course of treatment.

The proposed regulations also would add several new examples to illustrate these requirements.

Finally, the proposed regulations would establish a new mandatory notice stating the fixed indemnity coverage is not comprehensive health insurance and doesn't have to include most Federal consumer protections for health insurance.

Proposed Effective Dates

The proposed effective date for the changes to the Code section 105(b) regulations could be as early as January 1, 2024. Presumably, any payments from these plans occurring after the effective date would have to be excludable under Code section 104(a)(3) (i.e., if the premiums were paid after-tax) or they would be included in recipients' gross incomes.

For the proposed changes to the excepted benefit rules, existing hospital indemnity and other fixed-indemnity plans would have until plan years beginning on or after January 1, 2027 to come into compliance, although the notice requirement would take effect almost immediately.

Comments on the proposed regulations are due by September 11, 2023.

SECURE 2.0 Update – Where Does Guidance on 2.0 Stand?

Seven months after the enactment of the SECURE 2.0 Act, stakeholders are waiting to hear from the federal agencies tasked with issuing guidance on many of the law's provisions. In this article, we recap guidance on SECURE 2.0 that has already been released, discuss which guidance some congressional lawmakers think should be prioritized, and highlight which projects could be addressed in the near-term.

Recent SECURE 2.0-Related Guidance and Actions

Since SECURE 2.0 was enacted on December 29, 2022, there has been relatively little guidance issued in connection with the law's provisions. The most notable piece of guidance released so far is an Internal Revenue Service ("IRS") Notice published in May. Notice 2023-43 provides interim guidance on section 305 of SECURE 2.0, which expands the IRS's Employee Plans Compliance Resolution System ("EPCRS") by allowing more employers that use EPCRS to correct plan errors to self-correct (rather than making a more onerous submission to the program). The guidance allows plan sponsors to self-correct certain plan failures before the IRS officially updates EPCRS to reflect the changes made by SECURE 2.0 (which it has not done yet). (See Rewards Policy Insider 2023-12 for a more in-depth discussion of Notice 2023-43.)

More recently, the Department Labor ("DOL") announced on July 12, 2023 that it has launched an initiative to empower workers through ownership arrangements, as part of section 346 of SECURE 2.0. Section 346 requires the Secretary of Labor to establish an "Employee Ownership Initiative" to support existing and new programs within states designed to promote employee ownership, such as through employee stock ownership plans ("ESOPs"). The initiative includes the creation of a new division within DOL's Employee Benefits Security Administration which will, among other things, provide education, outreach, and training to inform employees and employers about the possibilities and benefits of worker ownership and business ownership succession planning.

In addition, on July 14, 2023, the IRS released guidance (Notice 2023-54) providing relief regarding recent changes made to the required minimum distribution ("RMD") rules. With respect to SECURE 2.0, the guidance provides relief for certain distributions from retirement plans that were made in 2023 that were mischaracterized as RMDs as a result of SECURE 2.0's increase in the age at which individuals are required to take RMDs. (This guidance will be discussed in more detail in a future Rewards Policy Insider.)

Lawmakers Weigh in on Guidance Priorities

Lawmakers on Capitol Hill have also taken to voicing their thoughts on SECURE 2.0 guidance priorities. On May 30, 2023, Senators Bernie Sanders (I-VT) and Bill Cassidy (R-LA) wrote a letter to DOL urging the agency to prioritize guidance related to certain provisions of SECURE 2.0. The Senators, who are Chairman (Sanders) and Ranking Member (Cassidy) of the Senate Committee on Health, Education, Labor, and Pensions, stated that they hoped DOL would "effectively and expeditiously" implement SECURE 2.0's retirement reforms. They also singled out several provisions of SECURE 2.0 that they believe the department should prioritize, including: (1) guidance relating to the Employee Ownership Initiative; (2) guidance relating to the newly created emergency savings accounts linked to individual retirement accounts; and (3) the consolidation of the various notices required to be sent to defined contribution plan participants. As discussed above, DOL appears to have already been responsive to the Senators' requests to prioritize the Employee Ownership Initiative. It remains to be seen whether DOL will heed their request to prioritize guidance for the other provisions in their letter.

Regulatory Agenda Highlights Future Projects

The Biden Administration's recently released Regulatory Agenda, which previews federal regulatory activities that are expected to be proposed or finalized in the next six to 12 months, also provides insights on what SECURE 2.0 guidance projects the agencies might tackle soon. DOL's agenda includes several SECURE 2.0-related projects that are currently in the very early stages. These projects include guidance relating to improving retirement plan disclosures, the emergency savings accounts linked to individual retirement accounts, and a new statutory exemption related to automatic portability. DOL notes on its agenda that it is holding stakeholder meetings regarding these provisions. Similarly, the Treasury Department's agenda includes a project – targeted for December 2023 – to propose regulations providing guidance on the SECURE Act of 2019's requirement that 401(k) plans allow long-term, part-time employees to contribute to the plan. The Agenda shows that the project will also address certain related changes made by SECURE 2.0. While the dates specified on Regulatory Agendas are often pushed back, the Agenda provides insight into what the agencies intend to prioritize in the coming months regarding SECURE 2.0 guidance.

Changes Coming to Connecticut Paid Leave; New York City Considering Additional Leave for Any Reason

2023 has proven to be a busy year for state and city legislative activity related to paid leave. In June, Connecticut expanded its paid leave law to cover (1) a new category of time off for family violence and sexual assault; and (2) mental health wellness days. In addition, New York City is considering an expansion of its leave law through a bill that would cover leave for "personal" time off.

Connecticut

On June 26, 2023, the governor of Connecticut signed into law S.B. 2, which makes changes to Connecticut's existing paid leave law. Connecticut first enacted paid sick leave in 2012. Under current law, certain employees can accrue one hour of paid sick leave for every 40 hours they work, capped at 40 hours annually. Generally, the law applies to employers with 50 or more employees who qualify as "service workers" (including, for example, retail, healthcare, food service, and secretarial workers). Paid sick leave may generally be used in connection with a service worker's illness, injury or health condition; for a similar condition of the service worker's child or spouse; and, where a service worker is a victim of family violence or sexual assault, services in connection with related medical care or counseling, or time needed to relocate due to such violence or assault or participate in any related civil or criminal proceedings.

Starting on October 1, 2023, Connecticut's paid leave law will be expanded in two key ways. First, the new law expands the existing paid leave allowance for family violence or sexual assault to include time off where a service worker is the parent or guardian of a child who is a victim of such violence or assault (as long as the parent is not the alleged perpetrator). Second, the law adds a new category for which service workers can use their paid sick leave – for a "mental health wellness day." This term generally means a day during which a person can attend to their emotional and psychological well-being instead of working their shift. These changes will require employers subject to Connecticut's paid leave law to review and update their leave policies ahead of the October 1st effective date.

New York City

The New York City Council is also considering an expansion of the city's own sick and safe leave law in a bill (Int. 1106-2023) introduced on June 22, 2023. New York City law currently requires employers with 100 or more employees to provide up to 56 hours of paid safe and sick leave annually (or 40 hours, in the case of employers with five to 99 employees).

Under the bill, New York City employers would additionally be required to allow employees to accrue up to 80 hours of "personal time" annually. This term generally means time that can be used for an absence from work for any reason. Employers with five or more employees, employers with one or more domestic workers (e.g., a housekeeper or a person who provides care for a child or elderly person, and employers with four or fewer employees that had a net income of $1 million or more during the previous tax year would be required to provide their employees with paid personal time leave. Other employers would be required to provide their employees unpaid personal time leave. Employees who use personal time leave would not be required to provide any documentation to their employer.

Other Newsworthy Updates

In other paid leave news, New York Governor Kathy Hochul recently reached an agreement with multiple state labor unions to expand existing paid parental leave for state employees. According to the governor's office, if these agreements are ratified, paid parental leave would be expanded to cover more than 80% of New York State workers.

At the federal level, some Democrats are focused on efforts to provide universal paid leave. In May, for example, Representative Rosa DeLauro (D-CT) and Senator Kirsten Gillibrand (D-NY) introduced legislation to create a permanent, national paid family and medical leave program. Given the partisan nature of national paid leave, it seems unlikely that this bill will gain much traction in either the House or the Senate. But the proposal – along with the recent activity in Connecticut and New York City – is a sign that paid leave remains a hot topic at all levels of government.

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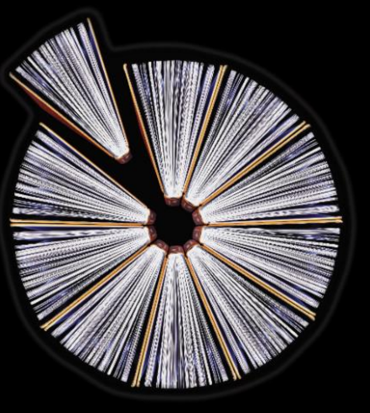

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