



Tax Consequences of Medical Loss Ratio Rebates

Under the Affordable Care Act, health insurers that fail to meet minimum medical loss ratios (MLR) must provide annual rebates to policyholders beginning in 2012. These rebates can be paid to group or individual policyholders as cash or reflected as a premium reduction. Further, the rebate can potentially create additional taxable income to employers and employees alike.

Tax Impact on Insurance Companies

MLR rebates paid by the insurance companies are considered return of premiums paid that reduce the insurance company's taxable income, regardless of whether they are paid as cash or premium reductions. Insurance companies will need to file Form 1099-MISC for those recipients not exempt from 1099 reporting when:

1. Rebate payments to the policyholder totals \$600 or more.
2. The insurance company knows that the rebate payments constitute taxable income to the policyholder or can determine how much of the payments constitute taxable income.

Tax Impact on Purchasers of an Individual Policy

The tax treatment of a rebate paid in 2012 to an individual who purchased and paid premiums for a health insurance policy in 2011 follows the tax benefit rule. Therefore, to the extent the policyholder received a tax benefit for premiums paid in the previous year, rebates received will need to be included in gross income of the recovery year. If the individual did not deduct the premiums in the previous year, the rebate would not be subject to federal income tax.

Tax Impact on Employees Making After-Tax Premium Payments to Group Policies

Rebates paid to group policyholders will be split between the employer and employee based on the pro-rata portion of the premiums paid. The tax treatment for the employees will differ depending on whether the rebates get distributed to all current participants, or only to participants who were also participants in the plan during the previous year.

In general, the tax treatment of rebates paid only to participants in the plan, who were also participants under the plan in the previous year, follows the tax benefit rule. For example, if the employee deducts the after-tax premiums paid on their prior year's tax return, the rebate received in the following year will constitute taxable income to the extent the individual received a tax benefit from the deduction. Conversely, if the employee did not deduct the after-tax premiums on their prior year's tax return, the rebate would not be subject to income taxes in the year received.

On the other hand, if the rebates are paid to all participants under the plan in the year in which the rebate is received, the rebates are to be considered a purchase price adjustment that reduces the cost of the employee's premiums for the current year, regardless of whether they received a tax benefit for the prior year's premiums paid.



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In either case, the rebate would not be subject to any additional federal employment taxes since it is a return of amounts that have already been subject to federal employment taxes.

Tax Impact on Employees Making Pre-Tax Premium Payments to Group Policies

If the employee pays premiums with pre-tax dollars and receives a portion of the rebates, the rebate constitutes taxable income and is also subject to employment taxes in the year received. This is so regardless of whether the rebates are provided only to employees participating in the plan in the year the rebates are paid or to employees participating in the plan both in the year the premiums are paid and the year for which the premiums were provided.

Tax Impact to Employers

As explained earlier, rebates received by employers may be due, in whole or in part, to the employees or to the employer. The portion of the rebate due to the employer will be taxable income to the employer either as a direct cash receipt or through a reduction of the expense. However, the employer gets to decide how to distribute the employee portion. As explained above, the employer can decide to remit the rebate to the employees directly or have the rebate used for the employees benefit through a reduction of withholding. If the rebates are remitted to the employees directly, the employer then must understand whether or not this remittance is subject to employee taxes. The employer also is deciding whether to provide the employee portion of the rebates to those participating in the plan in the year the premiums were paid or to those participating in the plan currently. Additional difficulty is possible when employers offer more than one insurance plan. The rebates are product specific. Therefore, if an employer offers a PPO and HMO, it is possible that a rebate will be received for the PPO but not the HMO, or vice versa.

For further information, please contact your Dixon Hughes Goodman tax advisor, **Eric Moody** at **828.236.5749** or eric.moody@dhgllp.com.

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