

INDEMNITY PLANS

WHAT ARE THEY?

At their core, indemnity plans¹ provide fixed, cash payments upon the occurrence of a health-related event & exist outside the Affordable Care Act's (ACA) regulations. In recent years, arrangements claiming to provide tax benefits via a monthly "wellness payment/benefit" have sprouted. These "plans" have prompted questions & analyses of whether such arrangements are "too good to be true" or whether they run afoul of tax law. Review indemnity policy types & other plans below; read on for assistance in analyzing market products.

Indemnity Health Plan - a type of health plan where the insurance company pays a pre-determined percentage of the [reasonable & customary](#) charges for a given service & the insured pays the rest.

Fixed Indemnity Plan - a type of medical insurance that pays a pre-determined amount (*e.g., fixed, cash payment*) on a per-period or per-incident (health-related) basis, regardless of total charges incurred. Includes hospital indemnity plans.

Fixed Indemnity Excepted Benefits Coverage is exempt from federal consumer protections & requirements for comprehensive health insurance. Coverage is designed to provide a source of income replacement, rather than full medical coverage. As of March 2024, a [new rule](#) requires consumer notice in the group market clarifying that coverage is not comprehensive.

Short-Term Limited-Duration Insurance (STLDI) is a type of health insurance designed to fill a temporary gap in coverage when an individual is transitioning from one source of coverage to another. It is not *individual health coverage* under the ACA. In March 2024, federal departments [amended the definition](#) of STLDI to reduce the initial contract term & require updated notice provisions.

Self-Insured Medical Reimbursement Plan (SIMRP), or [Section 105](#) plan, is a plan which reimburses employees for medical expenses not provided by either an accident & health insurance policy, or a prepaid healthcare plan regulated under federal or state law. It is a direct reimbursement plan: the employer pays employees for medical care expenses.

Wellness Indemnity Policy - a type of arrangement where the insured receives a fixed monthly "wellness payment." These types of plans propose tax savings. However, there is debate whether this monthly "payment" is truly tax exempt or whether it's considered "double-dipping." Read on for details. *See also: [IRS Memo on Tax Treatment](#)*

¹ Hospital indemnity or other fixed indemnity insurance provides fixed, cash payments upon the occurrence of a health-related event. Benefits are paid regardless of the amount of expenses a consumer incurs. Fixed indemnity insurance has traditionally been used as a form of income replacement, and it is not a substitute for comprehensive coverage. Source: [Short-Term, Limited-Duration Insurance Fact Sheet July 2023 CMS](#)

WHAT DO EXPERTS SAY?

Per The Council of Insurance Agents & Brokers (CIAB):

Generally, there are two types of fixed-indemnity arrangements with a “wellness payment” component:

Programs that offer minimum value plans (e.g., those offering free physicals) with indemnity plans.

A minimum value plan combined with indemnity is arguably permissible under current IRS rules. However, the IRS proposed a rule that would bar offering indemnity plans with any ACA plans.

[See CMS Fact Sheet in footer.](#)

We have argued that they should not impose such a bar if the ACA plans include coverage for all the essential benefits. We are awaiting issuance of that final rule.

[See CIAB Letter in References](#)

Arrangements purporting to convert *regular income* into *non-taxable income* through the deployment of indemnity arrangements.

We have materials arguing these arrangements are clearly violative of current IRS rules & requirements; there may be employer liability for unpaid taxes if they offer such arrangements.

[See CIAB Article in References.](#)

Tax Treatment of Certain Benefit Payments in Fixed Amounts Received Under Employer-Provided Accident & Health Plans²

The Treasury Department & IRS proposed amendments in [July 2023 proposed rules](#) to clarify that:

- ✓ **payments** from employer-provided fixed indemnity health insurance plans (and other similar plans) are not excluded from a taxpayer’s income if the amounts are paid without regard to the actual amount of any incurred medical expenses; and
- ✓ **the taxpayer** must meet substantiation requirements for reimbursements for qualified medical expenses from any employer-provided accident & health plan to be excluded from the taxpayer’s gross income.

The Treasury Department & the IRS are not finalizing proposed amendments at this time to study issues & concerns raised.

² [March 28, 2024, CMS Factsheet re: Final Rule](#)

- ✓ “The core problem with each iteration of the product (*i.e., certain fixed indemnity health plans with a wellness benefit*) is that nothing we have seen will allow ‘double-dipping’ with tax benefits. The IRS has clearly indicated that if premiums are paid on a tax-free basis, then the benefits are taxable.”
- ✓ “There is an important exception that these products attempt to use: that benefits will be excluded from gross income to the extent they are paid, directly or indirectly, to the taxpayer to reimburse the taxpayer for expenses incurred for the *prescribed* medical care.” *See IRS Ruling in References.*

The problem in these various products is that the individual receives a benefit whether he has incurred an unreimbursed medical expense.

- ✓ “For example, in one product, the *medical expense* that triggered the benefit was the completion of a health risk assessment. Unless the employee paid out-of-pocket to complete the health risk assessment (they did not), this benefit is fully taxable. *See Maynard Opinion in References.*
- ✓ “We are not out to shut down programs that can benefit clients. We have put much time into evaluating these products in the hope that it could deliver the benefits it promises. Unfortunately, the law simply does not allow it to do so; and, we think, puts the individual taxpayer at risk, in addition to the employer, the broker, and the vendor.”
- ✓ “Other than the narrow exception discussed above—the law works to prevent tax free benefits when the plan is paid for on a pre-tax basis (*i.e., the law works to prevent double-dipping*).”
- ✓ “As a result, these products only benefit employees who would already have unreimbursed out-of-pocket medical expenses that exceed the value of the benefit they provide. *It is unclear if it would even benefit them since those unreimbursed, out-of-pocket medical expenses are not what actually triggers the payment.*”

³ [Employee Benefits & Executive Compensation \(maynardnexsen.com\)](https://www.maynardnexsen.com); *See Maynard Opinion in References.*

WHAT'S THE LAW?

IRS Code: Sections 105 & 213

26 CFR § 1.105-1 - Amounts attributable to employer contributions.

- ✓ **§105(b)** provides an *exclusion* from gross income with respect to the amounts referred to in [§105\(a\)](#) which are paid, directly or indirectly, to the taxpayer to reimburse him for expenses incurred for the *medical care* (per §213(e)) of the taxpayer, his spouse, & his dependents.

26 CFR § 213 - Medical, dental, etc., expenses.

- ✓ The exclusion above does not apply to amounts which are attributable to (and not more than) deductions allowed under [§213](#) (*medical care expenses*) for any prior taxable year.
- ✓ [§105\(b\)](#) applies *only to amounts which are paid specifically to reimburse the taxpayer for expenses* incurred by him for the *prescribed medical care*. It *does not apply* to amounts which the taxpayer would be *entitled to receive irrespective of whether he incurs* expenses for *medical care* – in other words, for a “wellness payment” type of arrangement.

PATRIOT'S STANCE

Currently, and in accordance with expert opinions, Patriot does not support selling or promoting *fixed indemnity plans with a wellness benefit* to our clients. In the event the IRS issues an opinion that unequivocally permits such programs without running afoul of the Code, Patriot will reconsider relevant business opportunities.

REFERENCES

- ✓ [CIAB Article](#): Buyer Beware - The Rise – and Inevitable Fall? – of Health “Screening” Group Indemnity Policies
- ✓ [CIAB Letter](#) RE: Short-Term, Limited-Duration Insurance Proposed Rule – CMS-2023-0116
- ✓ [IRS Ruling](#) - Short-Term, Limited-Duration Insurance & Independent, Non-coordinated Excepted Benefits Coverage
- ✓ [Maynard Opinion](#) on Tax Treatment of Benefits Paid by Fixed Indemnity Health Plans