CRC BENEFITS

If It Sounds Too Good to Be True, It Probably Is

Every year, a new wave of arrangements shows up in the employee benefits market promising employers dramatic savings, enhanced tax advantages, or a clever way to deliver more value to employees without spending more money. Some of these ideas are legitimate innovation. A growing number are not. They are aggressive, sometimes abusive structures that cross into noncompliant territory, and the brokers and employers who get pulled into them are the ones left holding the risk when regulators take notice.

Three categories show up consistently enough to be worth naming directly: wellness plans used as disguised tax avoidance, charity care arrangements that quietly shift high-cost employees off the group plan, and cash-in-lieu-of-benefits structures that mischaracterize taxable wages as tax-free payments. Each is actively marketed with polished materials and confident sales pitches. None of that changes what they actually are under the law.

WELLNESS PLANS AS DISGUISED TAX AVOIDANCE

The structure typically looks like this: employees reduce their taxable wages through a Section 125 cafeteria plan, those contributions fund a self-insured medical reimbursement arrangement or a fixed-indemnity policy, and the plan pays out pre-set cash "wellness benefits" that are marketed as tax-free. Employees receive payments for activities like completing a health risk assessment or a telehealth visit, often with no actual out-of-pocket cost tied to those activities in the first place.

The IRS addressed this directly in a June 2023 Chief Counsel Memorandum, concluding that payments from these wellness programs are taxable wages, that payments must be tied to actual substantiated medical expenses to be tax-free, and that these arrangements are not reimbursements of real medical costs at all. Under Internal Revenue Code Section 105, only payments reimbursing substantiated expenses, limited to the amount actually incurred, can be excluded from income. These programs fail that standard because the payments are fixed amounts disconnected from real costs, and because the structure ties the payment to employment rather than to an actual expense.

The consequence is that the IRS treats these payments as ordinary wages, subject to income tax withholding, FICA, and federal unemployment tax, with state-level equivalents applying where relevant. For an employer who adopted one of these programs based on a promoter's promise of payroll tax savings, the eventual bill includes back taxes, penalties of up to 20% of the underpayment, and interest, on top of potential ERISA fiduciary exposure.

CHARITY CARE ARRANGEMENTS AND RISK DUMPING

A second model identifies high-risk or high-cost employees and moves them out of the employer's group plan entirely. A third-party partner, often labeled as a charitable organization or assistance program, facilitates their placement into individual market coverage, sometimes paired with a subsidized coverage program or a prepaid card to offset out-of-pocket costs. The pitch to the employer is straightforward: reduced claims exposure and a better-looking renewal.

The problem is what this actually does. Framed as helping employees access better options, these arrangements often shift financial burden away from the employer, exploit gaps in subsidized coverage systems, and risk discriminating against the very employees who need coverage most. The compliance exposure spans HIPAA, ACA, and ERISA, touching nondiscrimination rules, fiduciary duties, eligibility requirements, and employer shared responsibility provisions. If a strategy works by removing high-risk individuals to improve plan economics, that is a meaningful signal of compliance exposure, not a savings opportunity.

CASH IN LIEU OF BENEFITS, STRUCTURED WRONG

Offering employees additional compensation for declining health coverage is a common and generally permissible practice. It is also one that gets misused. Cash payments made in lieu of benefits are taxable wages, full stop, and must go through income tax withholding, FICA calculations, and proper W-2 reporting. Some arrangements attempt to disguise these payments as non-taxable benefits through reimbursement-style structures that do not hold up under ACA or IRS rules.

One detail worth flagging directly: employers with 20 or more employees cannot offer cash-in-lieu arrangements to Medicare beneficiaries. That structure is prohibited under the Medicare secondary payer rules, regardless of how the arrangement is framed. Mischaracterizing cash-in-lieu payments creates payroll tax liability, penalties for failure to withhold, distortions in ACA affordability calculations, and reporting errors on W-2 and 1095-C forms. The fix is straightforward: document these payments clearly and tax them properly from the start.

THE PATTERN ACROSS ALL THREE

The warning signs repeat across each of these categories. Promises of significant, almost too-easy tax savings. Arrangements that recharacterize wages as benefits. Structures that never quite substantiate actual expenses. Complex models involving third-party partners or charitable intermediaries that exist primarily to facilitate the structure rather than serve a genuine purpose. Sales materials leaning heavily on testimonials, hypothetical savings illustrations, and legal opinions that read as generic and quietly shift responsibility back onto the employer.

Promoter-provided legal opinions and marketing materials do not satisfy reliance standards for penalty protection. Indemnification promises tied to using the plan should raise the same concern rather than offer comfort.

WHERE THE ADVISOR ROLE MATTERS MOST

Advisors are often the first and sometimes the only line of defense between a client and one of these arrangements. Filtering out noncompliant solutions before they reach the employer, educating clients on why a pitch that sounds too good is worth scrutinizing, and recommending independent legal and tax review before adopting any nontraditional benefit design are all forms of protection that genuinely matter.

The standard worth applying consistently: assume any payment not tied to a substantiated medical expense is taxable wages until proven otherwise. Encourage clients to request analysis specific to their own facts rather than relying on a promoter's generic illustration. And weigh the long-term exposure, ERISA fiduciary implications, employee communication risk, and regulatory scrutiny, against whatever short-term savings the pitch promises.

BOTTOM LINE

Innovative benefit design should add genuine value, not create hidden liability. Regulators are aware of these arrangements, guidance has been issued, and enforcement activity is real and growing. Short-term savings rarely justify the long-term legal and financial exposure that follows. Compliance is not exciting, but neither are audits, penalties, or fiduciary liability.

Your CRC Benefits compliance team is available to help you evaluate any arrangement that raises questions before a client moves forward. Reach out at crcbenefitscompliance@crcgroup.com.

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