Taxability of Wellness Program Rewards

Employer-sponsored wellness programs often incorporate rewards or incentives to encourage employees to participate. Because there are numerous legal requirements for wellness program design, employers sometimes overlook the federal tax implications of a program's rewards.

As a general rule, wellness incentives are subject to the same federal tax rules as any other employee rewards or prizes. That is, unless a specific tax exemption applies to the incentive, the amount of the incentive (or its fair market value) is included in an employee's gross income and it is subject to payroll taxes.

There is no specific tax exemption for wellness program incentives. The two main federal tax exemptions that apply to wellness incentives are the exclusions for medical care and employee fringe benefits. Cash and cash equivalents (for example, gift cards) are a common type of wellness incentive that are always taxable. Other wellness rewards, such as small gifts or reduced cost sharing under a group health plan, may be nontaxable.

LINKS AND RESOURCES

- IRS Chief Counsel Memorandum 201622031, addressing the general tax rules for wellness program incentives
- IRS Chief Counsel Memorandum 201703013, addressing the taxability of fixed indemnity payments from wellness programs
- IRS Publication 15-B, Employer's Tax Guide to Fringe Benefits

Wellness Programs

Summary of Tax Rules

Workplace wellness programs often incorporate incentives or rewards to promote healthy lifestyle choices and to avoid, or even treat, chronic health conditions.

The Internal Revenue Code (Code) provides that, unless a specific exemption applies, all employee compensation (including fees, commissions, fringe benefits and similar items) is taxable. When compensation is taxable, it must be included in gross income on the employee's Form W-2 and it is subject to federal income tax withholding. It is also generally subject to federal employment tax withholding (FICA and FUTA).

Federal tax law does not include a specific exemption for wellness program incentives. While coverage by an employer-provided wellness program that provides medical care is generally excluded from an employee's gross income, wellness incentives are subject to the same tax rules as any other employee rewards or prizes. That is, unless a specific tax exemption applies to the incentive, the amount of the incentive (or its fair market value) is included an employee's gross income and it is subject to payroll taxes.

The two main tax exemptions that apply to wellness incentives are the exclusions for **medical care** under Code Sections 105 and 106 and employee **fringe benefits** under Code Section 132.

Key Point

Any reward, incentive or other benefit provided by a wellness program that is not medical care is included in an employee's income, unless it is excludible as an employee fringe benefit under Code Section 132.

Tax Rules for Common Incentives

The following tax rules apply to common wellness program incentives:

- Cash and cash equivalents—Cash and cash equivalents (for example, a $100 gift card for taking a health risk assessment) are **always taxable**. The cash amount (or gift card value) must be included in the employee's income and is subject to payroll taxes.
- Gym or health club memberships—An IRS memorandum indicates that an employer's payment of gym or health club membership fees is taxable, unless the membership qualifies as medical care. Gym or health club memberships typically do not qualify as medical care, unless they are prescribed by a doctor to treat a specific illness.
- Healthy snacks, water bottles and T-shirts—An employer may be able to exclude these items from employees' income as a nontaxable de minimis fringe benefit, depending on the value of the benefit and its frequency.
- Health seminars or classes—An employer may be able to exclude these items from employees' income as a nontaxable de minimis fringe benefit, depending on the value of the benefit and its frequency.
- Use of on-site athletic facility—An employee's use of a gym or other athletic facility on the employer's premise is a nontaxable fringe benefit if substantially all the facility's use during the calendar year is by employees, their spouses and their dependent children, and the facility is operated by the employer on premises owned or leased by the employer.
- Employee discounts—An employee discount on property or services the employer offers for sale to customers may be nontaxable if it meets the requirements for a qualified employee discount.
- Paid time off—Any wages paid for the additional time off are taxable (that is, included in the employee's gross income and subject to payroll taxes).
- Reduction of cost sharing under a group health plan (for example, premiums, deductibles or copayments)—Reductions or waivers of employee cost sharing under a health plan are nontaxable medical care expenses.
- Employer contributions to a health FSA, HRA or HSA—An employer's contributions to a health flexible spending account (FSA), health reimbursement arrangement (HRA) or health savings account (HSA) are nontaxable medical care expenses. However, each of these medical accounts is subject to nondiscrimination rules under the Code. If employer contributions fail these nondiscrimination tests, there will be adverse tax consequences.

In addition, one type of wellness program design that has been the subject of IRS scrutiny requires employees to make pre-tax premium payments to participate in the program. The wellness plan then pays a **cash benefit** per wellness activity (for example, $100 for completing a health risk assessment) or per pay period for participating in the wellness program. According to an IRS memorandum, these fixed indemnity wellness plan benefits are **taxable** and should be included in employees' gross income and wages.

Common tax mistakes that employers make when it comes to their wellness program incentives include:

- Incorrectly assuming that because coverage under a wellness program is nontaxable to employees, any incentives that employees receive under the program are also nontaxable;
- Incorrectly assuming that because wellness program incentives tend to be nominal, they are nontaxable; and
- Failing to communicate the incentive's taxability to employees, which may disappoint employees who were not expecting to pay taxes on the incentive.

Specific Tax Exclusions

Medical Care

Amounts paid by employers or received by employees for medical care are nontaxable under Code Sections 105 and 106. "Medical care" for federal tax purposes is defined in Code Section 213(d). This definition includes amounts paid "for the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body." Expenses that are merely beneficial to an individual's general health and well-being are generally not medical care expenses.

Coverage under an employer-provided wellness program that provides medical care is generally nontaxable, and any medical care that is provided by the program (for example, high blood pressure screenings and vaccinations) is also nontaxable. Similarly, wellness program rewards that take the form of reductions in employee cost sharing (for example, premiums or deductibles) for health plan coverage or additional employer contributions to a health FSA, HRA or HSA are generally nontaxable. Before implementing this type of wellness plan design, however, employers should confirm that these reductions in cost sharing or additional health FSA, HRA or HSA contributions will not raise problems with nondiscrimination testing.

Fringe Benefits

Code Section 132 excludes certain types of additional employee compensation—called nontaxable "fringe benefits"—from income. Fringe benefits that are nontaxable are not included in employees' gross income and are not subject to income and employment tax withholding.

De Minimis (Minimal) Benefits—Code Section 132(e)

De minimis (or minimal) benefits are one type of nontaxable employee fringe benefit. A de minimis benefit is any property or service that has so little value (taking into account how frequently similar benefits are provided to employees) that accounting for it would be unreasonable or administratively impracticable. Cash and cash equivalent fringe benefits (for example, gift certificates and gift cards), no matter how little, are never excludable as a de minimis benefit.

The law does not specify a value threshold for benefits to qualify as de minimis. The determination will always depend on facts and circumstances. Examples of benefits that may qualify as de minimis fringe benefits include small gifts, occasional movie, theater or sports tickets, water bottles, coffee cups and T-shirts.

On-site Athletic Facilities—Code Section 132(j)(4)

An employee's use of an on-premises gym or other athletic facility is nontaxable if substantially all use of the facility during the calendar year is by employees, their spouses and their dependent children. The athletic facility must be located on a site that is owned or leased by the employer, and the facility must be operated by the employer.

Qualified Employee Discounts—Code Section 132(c)

An employee discount allows an employee to obtain property or services from his or her employer at a price below that available to the general public. This benefit is nontaxable if it meets the requirements of a qualified employee discount. A qualified employee discount is a price reduction that an employer gives to an employee on property or services that the employer offers to customers in the ordinary course of the line of business in which the employee performs substantial services.

A nontaxable qualified employee discount generally cannot exceed:

- For services, no more than 20% of the price charged to the general public for the service; and
- For products or merchandise, the employer's gross profit percentage multiplied by the price charged to the public for the property.

If the discount exceeds this amount, then only the excess is included in the employee's gross income. This exclusion does not apply to discounts on real property or discounts on personal property of a kind commonly held for investment (such as stocks or bonds). Also, a qualified employee discount is taxable to highly compensated employees if the discount that is not available on the same terms to all employees (or to a group of employees defined under a reasonable classification that does not favor highly compensated employees).
