

An Overview of Medical Loss Ratio (“MLR”) Rebates for Group Health Plans

- A health insurer owing MLR rebates in the group health insurance market for a given year must distribute those rebates by the following August 1. The rules regarding the proper recipient(s) and handling of MLR rebates for group health plans, and the tax treatment of those rebates, vary based on a number of factors.

Who Receives MLR Rebates From the Health Insurer in the Group Market?

- A health insurer generally will distribute the rebates to the *policyholder*, *i.e.*, the entity that contracts with the health insurer (typically the employer/plan sponsor), with two limited exceptions:
 1. With respect to a non-governmental plan that is not subject to ERISA (*e.g.*, a church plan), the health insurer will distribute the rebates to the policyholder only if the policyholder first provides a written assurance that it will use the rebates to benefit members. Otherwise, the health insurer will divide and pay the full rebate (including amounts attributable to premiums paid by the policyholder) directly to the members who were covered during the calendar year preceding the year that the rebate is distributed.
 2. If the group health plan has been terminated as of the date the rebate is paid, the health insurer will distribute the rebate (in equal amounts) directly to the members of the terminated plan, but only if the policyholder cannot be located (*e.g.*, if the employer has gone out of business).

How Must an Employer Handle MLR Rebates that is Receives?

- Different rules may apply depending on whether the plan is an ERISA plan, nonfederal governmental plan (*e.g.*, a state, municipal, or local governmental group health plan), or church plan.
- *ERISA Group Health Plans:* For ERISA group health plans, MLR rebates paid to a policyholder may constitute ERISA plan assets, in whole or in part, and thus may need to be handled pursuant to ERISA’s fiduciary standards. Plan fiduciaries must act prudently, impartially, solely in the interest of plan participants and beneficiaries, and in accordance with ERISA and the terms of the plan.
 - Plan assets are not defined under ERISA, but DOL regulations generally define them to include (1) amounts that a plan invests in another entity, and (2) amounts that a participant pays to an employer, or has withheld from wages, to be contributed to a group health plan. The DOL also has stated that plan assets are to be identified based on “ordinary notions of property rights.”
 - For example, if either the plan or the plan’s trust is the policyholder, then the insurance policy will be a plan asset, meaning the employer generally will have no interest in a related MLR rebate (in the absence of specific plan or policy language to the contrary). If, by contrast, the employer is the policyholder, and the insurance policy or contract and other instruments governing the plan may be read to provide that some or all of an MLR rebate belongs to the employer, then the employer will be allowed to retain that portion of the rebate.
 - The fact that the employer is the policyholder does not necessarily mean that the employer may retain the MLR rebate, however. The DOL directs that the rebate be allocated between the employer and the plan (as plan assets) by reference to the terms of the plan and the parties’ understandings and representations. In the absence of more direct evidence, the DOL looks to the sources of the premium payments. Note that this does not always mean that the rebate is allocated on a pro-rata basis (*e.g.*, where the employer contributes a fixed amount and the employees contribute the balance of the premium, the rebate would be allocated first to plan assets).
 - The fiduciary can pay the plan asset portion of the rebate in cash, or, if it determines that distributing payments is not cost-effective, utilize it for other permissible plan purposes, such as

reducing future participant premium payments or enhancing benefits. The fiduciary should weigh the costs and benefits in each case.

- Using a rebate generated by one plan to benefit members in another plan would constitute a breach of fiduciary duty.
- Rebates that constitute plan assets need not necessarily be held in trust if they are used to pay premiums or refunds within three months of receipt.
- **Nonfederal Governmental Group Health Plans:** The policyholder has three options to use the “member portion” of a rebate, *i.e.*, the amount of the rebate proportionate to the premiums that were paid by members:
 1. Reduce premiums for all members who, as of the date the rebate is received, are covered under *any* group policy offered under the plan.
 2. Reduce premiums for members who, as of the date the rebate is received, are covered by the specific group policy offered under the plan for which the rebate is being provided.
 3. Provide a cash refund to members who, as of the date the rebate is received, are covered by the specific group policy offered under the plan for which the rebate is being provided.

At the option of the policyholder, the rebates or premium reductions can be divided evenly among members, divided based on actual contributions to premiums, or apportioned in a manner to reasonably reflect relative contributions.

- **Group Health Plans that are not Government Plans and not subject to ERISA (e.g., Church plans):** In order to receive a rebate from the health insurer, the policyholder must provide a written assurance that it will use the member portion of the rebate in one of the three ways listed above for nonfederal governmental plans. Otherwise, the health insurer will pay the full rebate (including the portion attributable to the policyholder’s premium contribution) in equal amounts directly to members who were covered during the year preceding the year in which the rebate is paid.

How Are Employees’ MLR Rebates Treated for Federal Tax Purposes?

- If employee premium contributions are made on a pre-tax basis through a cafeteria plan, then any rebates paid to employees, regardless of form (*e.g.*, premium credits, cash payments, credit/debit card reimbursements, or pre-paid debit/credit cards), will be subject to federal income and employment taxes in the year paid.
- If employee premium contributions are made on an after-tax basis, then any MLR rebates paid to the employees, regardless of form, generally will not be subject to federal income or employment taxes, with one exception:
 - If the rebate is paid to an employee who participated in the plan in the year preceding the rebate distribution, and the employee previously deducted on his federal income tax return the premium payments made for that year, then the MLR rebate, regardless of form, will be subject to federal income taxes to the extent the employee received a tax benefit from such income tax deduction. The rebate will not be subject to federal employment taxes.

*

*

*

This document is intended to provide general guidance in connection with the medical loss ratio rebate provisions of the Patient Protection and Affordable Care Act, and the regulatory guidance issued thereunder. It reflects our understanding and interpretation of the current rules, which are subject to change. A more individualized analysis of a particular factual scenario, which takes into account all the relevant facts and circumstances, may be required in a given case.

Pursuant to 31 CFR Part 10, Section 10.35, any tax advice contained in this document was not intended or written to be used, and cannot be used, for the purpose of avoiding penalties.