MEMORANDUM OF LAW

DATE: March 25, 1994

TO: Valerie VanDeweghe, Flexible Benefits
Administrator, Risk Management Department

FROM: City Attorney

SUBJECT: Reimbursement of Health Insurance Premiums

In a memorandum dated March 1, 1994, you asked us to review our Memorandum of Law dated January 29, 1990, discussing whether health insurance premiums could be reimbursed through Flexible Spending Accounts ("FSA") described in Internal Revenue Code ("IRC") section 125. In that Memorandum of Law, we concluded that an FSA could be used to reimburse health insurance premiums. As you are aware, the consultant for the Flexible Benefits Plan (Sheldon Emmer with Foster Higgins) did not agree with our conclusion.

You indicated that when faced with this lack of consensus and in an abundance of caution, the Dental/Medical/Vision ("DMV") Reimbursement plan document and the Flexible Benefits Summary Highlights were changed to reflect that premiums would no longer be eligible for reimbursement. You also indicated that despite this change, the practice of reimbursement for dental and vision premiums deducted from an employee's paycheck for the Municipal Employees' Association's ("MEA") plan inadvertently continued.

Since you are recommending that this practice be discontinued and further since this will be brought to MEA's attention during the upcoming meet and confer process, you seek an immediate response. Finally, you indicated that an employee who was denied the opportunity to seek reimbursement of his premium for the Peace Officers' Association's plan through his DMV account has challenged the denial.

In response to your request, we have reviewed our previous Memorandum of Law, dated January 29, 1990, the proposed regulations governing FSAs, and other relevant publications discussing this issue. Our analysis follows.

DISCUSSION

Our Memorandum of Law dated January 29, 1990, discussed the interpretation of the then new proposed regulation clarifying 26 U.S.C. section 125. Specifically, pursuant to your request, we

focused on certain language in Question and Answer seven of proposed regulation Section 1.125-2 which you felt might preclude the City from allowing employees to use medical reimbursement money to pay dependent or spousal health plan premiums that are offered as part of the City's flexible benefit plan. The pertinent language in this question read:

> A health FSA may not treat participants' premium payments for other health coverage as reimbursable expenses. Thus, for example, a health FSA may not reimburse participants for premiums paid for other health plan coverage, including premiums paid for health coverage under a plan maintained by the employer of the spouse or dependent (emphasis added).

In our initial review, we focused on the phrase "other health coverage" and concluded that spousal or dependent insurance was not prohibited "other health coverage." In support of this conclusion, we noted that answer seven, subdivision (4) of the proposed regulation 1.125-2 specified that an FSA could only reimburse medical expenses as defined in 26 U.S.C. section 213. Section 213, we added, included insurance.

Our conclusion, however, does not appear to be the industry practice or standard. In addition to the information received from Foster Higgins, we have reviewed a publication prepared by Spencer's Research Reports, dated December 14, 1990, and Flexible Benefits-A How-To Guide, written by Richard E. Johnson, a managing director of William M. Mercer, Inc. Without exception, the industry practice is to prohibit reimbursements from an FSA for premiums for health insurance. As such, this restriction is an exception to the general rule that IRC section 213 expenses may be reimbursed through a health care FSA.

Your initial concerns in this area were thus well-founded. More importantly, your then conservative approach in discontinuing the practice of reimbursing health insurance premiums through FSA in 1990 tracks the industry practice.

CONCLUSION

In light of the foregoing authority and industry practice, we now expressly reject the conclusion reached in our Memorandum of Law dated January 29, 1990. For plan years beginning 1990, FSA's may not reimburse participants for medical plan premiums (commonly known as premium conversion). However, the regulations still permit premiums for employer-sponsored plans to be paid on a pretax basis through other parts of the cafeteria plan

utilizing the premium conversion feature. It is our understanding that you are currently doing this in conjunction with a commensurate salary reduction on either a pretax or postax basis depending on the employee's choice.

JOHN W. WITT, City Attorney
By
Loraine L. Etherington
Deputy City Attorney

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