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## Tobacco Surcharges

### INTRODUCTION

Many employers provide incentives to employees (and sometimes their family members) for not smoking or using tobacco products to encourage them to adopt healthier lifestyles and to potentially cut down on medical costs. However, some employers don't realize that putting such incentives in place may be considered a wellness program and subject to HIPAA and EEOC wellness rules. Employers choosing to use a tobacco-related incentive must be mindful of requirements such as incentive limits and reasonable alternative standards, as well as confidentiality notices if medical testing is involved.

### BACKGROUND

A wellness program with incentives tied to a group health plan (e.g. reductions in medical premiums or cost-sharing) must meet certain requirements to avoid violating HIPAA nondiscrimination rules. Such programs generally have to comply with requirements including, but not limited to, having limits on incentives and offering reasonable alternative standards.

A wellness program that requires an employee to undergo medical testing or give responses to disability-related questions to earn incentives must meet certain requirements to avoid violating the Americans with Disabilities Act (ADA). EEOC rules require such programs to comply with incentive limits, confidentiality and disclosure requirements, and more.

Most often, tobacco-related incentives are tied to the group health plan and are therefore considered health-contingent programs subject to HIPAA wellness rules.

EEOC wellness rules need to be considered only if medical testing (e.g. saliva or blood samples) is used to verify nicotine or tobacco use.

You can find a more detailed summary of both HIPAA and EEOC wellness rule requirements in our previous issue brief found here – <https://www.psfinc.com/articles/wellness-program-updates/>

### TYPES OF TOBACCO-RELATED INCENTIVES

Employers can choose to incent employees not to smoke or use tobacco products in a variety of ways. The most common options include (i) HSA, HRA or FSA contributions; (ii) a decrease in employee contributions toward medical coverage (often referred to as a tobacco surcharge); and (iii) cash, gift cards or entries into a prize drawing.

If the incentive does NOT affect the group health plan (e.g. cash, gift cards, prize drawing, HSA contributions), then HIPAA wellness rules do not apply. In other words, there would be no limit on the incentive unless medical testing were involved (in which case, the EEOC rules would impose a 30% incentive limit). In addition, it would not be necessary to offer a reasonable alternative standard.

However, for tobacco-related incentives, employers are more likely to tie the incentive to a group health plan, often imposing a tobacco surcharge on the monthly employee contribution for medical coverage. For such incentives, HIPAA wellness rules apply, including the 50% incentive limit and the requirement to offer a reasonable alternative standard to earn the incentive. In addition, if the employer requires medical testing, the EEOC wellness rules

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apply, further limiting the incentive to 30% and requiring a confidentiality disclosure. The HIPAA incentive limit and the requirement to offer a reasonable alternative standard are discussed further below.

#### HIPAA INCENTIVE LIMIT

Assuming that the incentive affects the group health plan, HIPAA wellness rules set a tobacco-related incentive limit of 50% of the total cost of coverage (employer and employee contributions combined). If the incentive is applicable only to the employee, the incentive limit is calculated based on the cost of single coverage. However, if both the employee and the spouse are eligible to earn the incentive, the incentive limit is calculated based on the cost of whichever tier of coverage the employee and spouse enroll in. NOTE: If the employer offers both non-tobacco and tobacco-related incentives, then the total combined incentives subject to HIPAA cannot exceed the 50% incentive limit (non-tobacco-related incentives capped at 30%).

*Example - Employer offers a mix of non-tobacco-related and tobacco-related incentives tied to the group health plan, but no medical testing is involved (therefore EEOC rules do not apply).*

	SINGLE	FAMILY
Monthly premium	\$450	\$1,200
Maximum non-tobacco-related incentives (30%) – difference permitted in employee contribution	\$135	\$360
Maximum non-tobacco and tobacco-related incentives (50%) – difference permitted in employee contribution	\$225	\$600

Most employer wellness program incentives do not come anywhere near the incentive limits outlined above. Typically,

only those employers choosing to provide significant incentives have to be careful. That being the case, tobacco-related incentives do tend to be the most aggressive.

#### HIPAA REASONABLE ALTERNATIVE STANDARD

The most common issue for tobacco-related incentives is that employers fail to offer a reasonable alternative standard, fail to provide notice of such standard, or fail to provide the full reward to those who satisfy the reasonable alternative standard.

Again assuming that the incentive affects the group health plan, HIPAA wellness rules require that those who do not satisfy the original standard (e.g. tobacco users or smokers) must be offered an opportunity to earn the full incentive by satisfying a reasonable alternative standard. This requirement was recently addressed in *Acosta v. Macy's Inc.* (2017). The Department of Labor (DOL) sued Macy's, alleging that its tobacco cessation program violated wellness rules by failing to have a compliant reasonable alternative standard and corresponding notice in place for avoiding a tobacco surcharge on medical premiums.

The employer has some flexibility in setting a reasonable alternative standard, but simply providing additional time to satisfy the same standard (e.g. stop using tobacco or smoking) is not compliant. In addition, guidance indicates that the individual must be provided with the full incentive following completion of the reasonable alternative standard, regardless of whether the individual actually stops using tobacco. There must be an annual opportunity to receive the incentive, either as a non-tobacco user or by satisfying the reasonable alternative standard. For example, a tobacco user could earn the incentive each year by annually completing a tobacco cessation course. Although employers sometimes find this frustrating, consider that these individuals still have to take extra steps to earn the incentive and must do so annually.

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Taking a tobacco cessation class and/or using tobacco cessation products are common options provided as reasonable alternative standards. The employer should provide a period of time for completion of the reasonable alternative standard and then provide the full incentive available to non-tobacco users for those who satisfy the requirement. If tobacco cessation classes are offered as the reasonable alternative standard, they must be provided at no cost. The regulations indicate that if the reasonable alternative standard is the completion of an educational program, the plan or issuer must make the program available or assist the employee in finding such a program, and cannot require the individual to pay for the cost of the program. Tobacco cessation classes and/or counseling can be found, and are often provided at no cost, through state-run programs. The time commitment must also be reasonable. If there is an option to use tobacco cessation products for a period of time, there is not the same requirement to cover the cost; but some coverage for tobacco cessation may be provided under the medical plan as preventive coverage.

### SPECIFIC CONSIDERATIONS FOR A TOBACCO SURCHARGE

For employers using a tobacco surcharge on employee contributions, a decision needs to be made about how to both handle the surcharge for those who are tobacco users and satisfy the reasonable alternative standard. Below are a few potential options:

1. Require the completion of the reasonable alternative standard prior to the beginning of the plan year (at least for those already employed).
2. Offer the lower employee contribution, and impose the surcharge prospectively for those who fail to complete the reasonable alternative standard.
3. Offer the lower employee contribution, and impose the surcharge retroactively (and prospectively)

for those who fail to complete the reasonable alternative standard.

4. Impose the surcharge, and return the money as additional taxable compensation for those who complete the reasonable alternative standard (the lower employee contribution would be charged prospectively).

Option 3 is the most problematic, because it may be difficult to collect the surcharge retroactively. And although §125 rules would clearly allow a prospective adjustment to pre-tax elections made through a cafeteria plan because of a change in cost of coverage, it is not clear that a retroactive change would be permitted (in other words, it might be necessary to collect retroactively on an after-tax basis).

It is also necessary to consider how the tobacco surcharge may impact affordability for applicable large employers (50 or more FTEs) subject to §4980H employer shared responsibility rules. For wellness incentives that affect the employee contribution toward medical coverage, the general rule of thumb is that the non-wellness rate (the higher rate) must be used for purposes of determining affordability. However, for a tobacco-related incentive, the rules permit an employer to use the non-tobacco rate to determine affordability.

*Example - Required monthly employee contribution is \$250/month, and wellness incentive reduces employee contribution to \$150/month.*

- *If the incentive is NOT tobacco related, coverage is "affordable" so long as \$250 does not exceed 9.86% (in 2019) of employee's household income. \$250.00 should be entered on Line 15 of Form 1095-C.*
- *If the incentive is tobacco related, coverage is "affordable" so long as \$150 (not \$250) does not exceed 9.86% (in 2019) of employee's household income. \$150.00 should be entered on Line 15 of Form 1095-C.*

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## ENFORCEMENT

Some employers simply use an employee attestation/affidavit certifying tobacco use or lack thereof, while others have taken it a step further and require medical testing. If the employer is using an affidavit/attestation (taking the employee's word) versus performing medical testing to confirm use, some decisions will need to be made about how much the employer wants to actively police whether employees were truthful on the affidavit. Keep in mind that some states have laws prohibiting employers from considering employee actions outside of work. A few things to consider for the affidavit:

- Clarify the definition of smoking and/or tobacco use. For example, are e-cigarettes included?
- Clarify whether the employee is indicating tobacco use currently, for a previous period, for a future period, or all three.
- Communicate the repercussions of falsification. For example, indicate whether the surcharge will be imposed retrospectively, or only prospectively, or whether coverage may be terminated (retrospectively or prospectively).

Whatever is decided, it would be advisable to have the affidavit reviewed by legal counsel to ensure that it correctly communicates the employer's intentions and enables the employer to enforce said intentions.

## SUMMARY

Although tobacco-related incentives continue to be a popular way to encourage changes in employee (and family member) behavior and are therefore often promoted by insurance carriers and wellness vendors, employers must carefully consider the incentives provided and whether wellness rules apply. Many tobacco-related incentives are tied to the group health plan, requiring compliance with, among other things, HIPAA incentive limits and reasonable alternative standards. Further, in an attempt to simplify enforcement efforts, some employers have moved toward medical testing to confirm use, which then requires compliance with lower EEOC incentive limits and confidentiality disclosure requirements.

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