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2016-0935 IRS provides temporary relief from certain Affordable Care Act rules for institutions of higher education offering subsidized student health coverage to graduate students

Since the enactment of the Affordable Care Act (ACA), the Department of the Treasury (Treasury) and Internal Revenue Service (IRS) have issued regulations and guidance under the ACA raising potential concerns for institutions of higher education that provide subsidized student health insurance coverage to their graduate students. This IRS ACA guidance raises the following question: "When is a student also an employee, and when is a student only a student even if the student provides services to the college or university?" Colleges and universities may have believed that the answer should be long-settled, but it has returned with the IRS ACA guidance.

Institutions of higher education had been particularly concerned that the IRS guidance could be interpreted as requiring them to treat certain graduate students as employees and to terminate or modify their existing subsidized graduate student health care arrangements. Recently issued IRS guidance ([Notice 2016-17](#)) provides temporary relief to colleges and universities that offer subsidized student health insurance coverage to their graduate students. (Substantially identical guidance was issued at the same time by the Departments of Labor (DOL) and the Department of Health and Human Services (HHS)).

This summary focuses on Notice 2016-17 and provides context for this guidance. Because the relief provided in the notice is temporary, institutions of higher education will need to consider how to manage their graduate student health care arrangements going forward.

Background

Whether a student may also be considered an "employee" is not always obvious and the answer may differ depending on the context. The

classification of a student worker may be addressed under different laws and different agencies, such as by the IRS in the administration of federal tax law, by the Department of Labor (DOL) in the administration of the Fair Labor Standards Act (FLSA), and by the National Labor Relations Board (NLRB) in the interpretation of the National Labor Relations Act (NLRA).

The DOL provides in its FLSA Field Operations Handbook that, for purposes of compliance with the federal wage and hour rules, a student will not be considered an employee, even if payment is received for work, as long as the student's activities are basically educational and certain other requirements are satisfied. Furthermore, the handbook provides that the DOL Wage and Hour Division generally will not consider a graduate student who is engaged in research in the course of obtaining an advanced degree to be an employee.

For purposes of collective bargaining, the prevailing NLRB ruling of *Brown Univ. & Int'l Union, United Auto., Aerospace & Agric. Implement Workers of Am., UAW AFL-CUI*, 342 NLRB 483 (2004), found that the university's relationship with its graduate students was primarily educational and not employment based. This ruling provides that graduate students at private institutions should not be treated as employees for purposes of collective bargaining under the NLRA.¹

For purposes of applying the employment tax rules (e.g., the Social Security and Medicare taxes under FICA), IRS regulations provide that students are not considered employees if they are enrolled and regularly attending classes; their work is incidental to their course of study; they are not employed on a full-time basis (40 hours or more per week); and they satisfy certain other requirements. (Treas. Reg. Section 31.3121(b)(10)-2.) The IRS issued this regulation exempting students from FICA taxes in accordance with a statutory provision that specifically exempts services performed in employment of a school, college or university for purposes of the employment taxes. (Internal Revenue Code Section (IRC) Section 3121(b)(10).)

Although the DOL, NLRB and IRS, in the circumstances described above, have found that a student is not considered an employee, a student providing services to a college or university may still be considered a "common law employee" of the institution. Many ACA provisions apply to the employment relationship between a common law employer and its common law employees.

ACA provisions and guidance applicable to higher education institutions

Importantly, the ACA reinforces the importance of student health coverage. ACA Section 1560(c) provides:

"Nothing in this title ... shall be construed to prohibit an institution of higher education ... from offering a student health insurance plan, to the extent that such requirement is otherwise permitted under applicable Federal, State or local law."

HHS relied on this provision to issue regulatory guidance providing that insured student health coverage is a type of individual market coverage offered to students and their dependents under a written agreement between the institution of higher education and a health insurance issuer. (See, HHS final regulations, 45 CFR 147.145.)²

Despite the mandate in the ACA to ensure the future of student health coverage, other provisions of the ACA have been interpreted in a manner that may cause colleges and universities to question how and when subsidized student health insurance coverage may be offered to graduate students who provide services to the institutions.

IRS regulations regarding the ACA employer excise tax

In early 2014, the IRS issued regulations that defined a "full-time employee" for purposes of the ACA employer excise tax under IRC Section 4980H. In this guidance, the IRS concludes that an "employee" is any individual who is an employee under the common law standard. An employee is considered "full-time" if the employee provides services to the employer for an average of 30 hours or more per week. The regulations provide no general exception for student workers from the definition of "employee." The only exception for student workers provided in the regulations is that hours of service performed by students in positions subsidized through the federal work study program, or a substantially similar program, do not count for purposes of determining whether the student is considered a full-time employee.

Based on the IRS standards for determining when a worker is considered a common law employee, the IRS may view a graduate student as the common law employee of a college or university if the student's teaching, research or other services are directed and controlled by the institution. If the graduate student is considered a common law employee under this test, the IRS would treat that student as an employee, but the institution would not be subject to the employer excise tax with respect to the student employee, unless the student is considered to be full-time employee by working at least an average of 30 hours per week.

IRS guidance regarding employer payment plans

IRS guidance on arrangements in which an employer subsidizes an employee's individual health care coverage also raised significant concerns for colleges and universities. In a series of notices, the IRS stated that employer-sponsored health reimbursement arrangements (HRAs) and employer payment plans (EPPs) that pay, or reimburse employees, for some or all of the premium expense incurred for individual market health insurance coverage are subject to the ACA market reform provisions. (See Notices [2013-54](#), [2015-17](#), and [2015-87](#).) The ACA market reform provisions apply to employer-sponsored group health plans, which are plans offered to the employer's *common law employees*. Because HRAs and EPPs would not satisfy the ACA market reform provisions, the employer sponsoring the plan could be subject to an excise tax under IRC Section 4980D up to \$100 per day, per affected participant.

Many major research universities offer student health insurance coverage at little or no cost to graduate students as part of their graduate school financial package. Sometimes these subsidies are provided regardless of the graduate student's activity and sometimes they are offered in relation to services a graduate student provides to the institution, such as teaching or research services.

After the IRS issued guidance on HRAs and EPPs, institutions of higher education became concerned about the application of the ACA market reform provisions to their premium reduction student health insurance coverage arrangements with graduate students. Because the IRS may view a graduate student providing teaching, research or other services as an institution's common law employee, the institution's premium reduction health care arrangement could be considered an employer-sponsored group health plan that would violate ACA market reforms because their subsidies would be used to purchase student health insurance — a type of individual market health care coverage — rather than a group health plan.

Transition relief for graduate student health care coverage

Notice 2016-17 provides that the IRS, DOL and HHS (the Departments) will not assert that an institution of higher education violated the ACA market reform provisions if the institution offers student-employees a premium reduction arrangement in connection with their student health insurance coverage. The notice defines a premium reduction arrangement as an arrangement "designed to reduce the cost of student health coverage (whether insured or self-insured) through a credit, offset, reimbursement, stipend, or similar arrangement." This enforcement relief applies for plan years beginning prior to January 1, 2017 or through the 2016-17 academic year.

The Departments recognized that some institutions of higher education may not have realized that the student health premium reduction arrangements that are integrated with student health insurance coverage may constitute a non-compliant HRA or EPP group health plan. To provide institutions with time to determine whether their arrangements comply with the ACA, the notice provides that the Departments will not take enforcement action against a higher education institution's premium reduction arrangements offered in connection with student health insurance coverage for plan years beginning before January 1, 2017 or through the 2016-17 academic year.

Implications of the transition relief

Notice 2016-17 provides institutions of higher education with welcome transition relief through the 2016-17 academic year, but it raises a number of issues that colleges and universities will need to consider.

Institutions of higher education will need to consider whether their graduate students are their common law employees. Because students who provide services on a non-full-time basis and satisfy other requirements are not subject to FICA and may also be exempt from certain FLSA wage and hour rules, many institutions may not have understood that the IRS may view graduate students who provide teaching, research or other services to the institution as common law employees. Premium reduction arrangements offered to the students who are common law employees would be subject to the ACA market reform requirements.

Institutions of higher education should review their graduate student premium reduction health care arrangements to determine whether changes need to be made to come into compliance with the ACA market reform requirements. Some of the alternatives that a college or university may consider include:

— Integrating the graduate student subsidized health care coverage arrangement with the institution's employer-sponsored group health plan. A subsidized employer-sponsored arrangement that is integrated with a group health plan complies with the ACA requirements. This alternative, however, would apply only to graduate students providing services to the institution who are treated as common law employees.

— Providing subsidized coverage in the student health plan to all graduate students regardless of whether the student provides services to the institution. This alternative would comply with the ACA market reform requirements because the subsidized coverage is provided to graduate students in their capacity as students and is not conditioned on the requirement that the student provide services to the institution. Although this alternative complies with the ACA market reform requirements, it leaves the

institution vulnerable to a violation of the employer mandate excise tax with respect to graduate students providing services who may be considered common law employees of the institution.

— Establishing a separate employer-sponsored plan for graduate students who provide services to the institution. Under this alternative, the separate arrangement would be treated as an employer-sponsored group health plan that would be subject to ERISA, the ACA market reform requirements, and other health laws applicable to group health plans.

A graduate student health care arrangement that is integrated with a self-insured student health plan may avoid violating the ACA market reform rules, but **only** if the graduate student is treated as an employee and the student health plan is treated as an employer-sponsored health plan. Self-insured student health plans that cover graduate students who are considered employees or other employees of the institution may run afoul of other ACA, ERISA, and tax issues that will need to be considered.

Institutions may also consider increasing the graduate student's stipend or other payments to permit the student to purchase health insurance directly on the individual market. Under this alternative, the increased payment likely would be included in the graduate student's gross income.

These alternatives may not be as attractive to the institution or the graduate students as continuing the existing arrangements, but, in the absence of intervening legislative or regulatory action, it will be important for all colleges and universities to consider alternatives to bring their subsidized graduate student health plans into compliance with the ACA.

RELATED RESOURCES

— For more information about EY's Exempt Organization Tax Services group, visit us at www.ey.com/ExemptOrg

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ENDNOTES

¹ The *Brown* ruling is being challenged before the NLRB in the matters of *The Trustees of Columbia University* and *New School*. The NLRB is expected to issue a decision in both of these matters by the end of the summer (2016).

² In a final rule issued in 2013, HHS provided that self-funded student health plans would be deemed to be minimum essential coverage for policy years beginning on or before December 31, 2014. 45 CFR 155 and 156. Thereafter, institutions of higher education and other schools that sponsor self-funded student health plans must apply to HHS to receive approval that the plan constitutes minimum essential coverage. Self-insured student health plan would not be considered individual market coverage because the coverage is not insured through a policy offered on the market.

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