

Is a health insurance opt-out bonus taxable?

Q. We give employees who opt out of our health plan a bonus. Do we withhold federal taxes on that bonus? — J.T., Illinois

A. Yes. Federal tax withholding must be applied to any remuneration paid to employees that is not specifically exempt from the requirement. While a specific exemption exists for employer-provided health care coverage that allows those amounts to be provided to employees on a tax-free basis, this exemption would not apply to a bonus offered in lieu of health care coverage. The bonus you describe would be considered compensation to employees subject to federal taxes and withholding.

In addition to the tax considerations, keep in mind that the addition of the option to receive cash consideration in lieu of nontaxable health coverage is likely to create a Section 125, or “cafeteria plan.” Employers that sponsor a cafeteria plan must comply with specific plan documentation, nondiscrimination and other requirements. In the event you provide such a bonus, it would be wise to consult with an experienced benefits practitioner to ensure your plan complies with all legal requirements.