EmployWell Program

Compliance Overview

EmployWell is a Strategic Wellness Alliance, giving employers a single point of contact to manage all wellness, tax-advantaged, and employee-benefit programs in one streamlined system.

Our platform is funded through two long-standing, legally vetted partnerships: **CP+** and **Attentive**. Both organizations have operated for **more than a decade with zero compliance issues**, and both are supported by **ERISA attorneys, independent tax counsel, and comprehensive legal reviews**.

Through these partnerships, **employers save an average of $700/employee/year in FICA taxes**, while employees save on **federal, state, and FICA taxes**. EmployWell funds its wellness programs, education resources, and benefits through a **percentage of these tax savings**—allowing companies to offer high-value benefits **at no net new cost**.

This compliance packet includes the official **legal reviews and white papers** from CP+ and Attentive to support your CFO, auditors, and legal team in reviewing the tax framework and regulatory foundation of the program.

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May 20, 2013

To whom it may concern

Ref: TradeCheck 132(d) Working Condition Fringe Benefit Plan Review

Dear Ladies and Gentlemen:

My firm reviewed the TradeCheck 132(d) Working Condition Fringe Benefit Plan (see attachment) for Tax Code compliance and applicability to both profit and non-profit business entities. I was retained to conduct the review in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of this review is to provide (i) background information relative to how and why the Internal Revenue Code, Regulations and Private Letter Rulings are provided as it pertains to the TradeCheck 132(d) Plan; (ii) provide an overview of the objectives of the associated Tax Code; (iii) provide an explanation of the law as it applies in to this 132(d) Plan; (iv) provide guidance to qualified reimbursements and (v) and provide the 132(d) Plan analysis relative to Tax Code compliance and applicability to all businesses.

(i) BACKGROUND:

The Tax Reform Act of 1986 significantly changed rules for deduction of employee business expenses by converting most of these expenses into itemized deductions that an employee could only deduct if the aggregate of such expenses exceeded the two-percent floor. However, the 1986 Act left in place the ability of a taxpayer to deduct from gross income and without regard to the two-percent floor, pursuant to Section 62(a)(2)(A), employee business expenses incurred by a taxpayer as part of a reimbursement or other expense allowance arrangement with his or her employer.

Congress responded by enacting Section 62(c) in Section 702 of the Family Support Act of 1988, 100 P.L. 485, 102 Stat. 2343 (1988). In describing the conference agreement, the House-Senate Conference Committee Report on that Act states that "[i]f an above the-line deduction is allowed for expenses incurred pursuant to a nonaccountable plan, the two-percent floor enacted in the [Tax Reform Act of 1986] could be circumvented solely by restructuring the form of the employee's compensation so that the salary amount is decreased, but the employee receives an equivalent nonaccountable expense allowance."

(ii) OVERVIEW:

The Tax Code provides for all employers to provide tax exempt reimbursements, as a Working Condition Fringe Benefit," to employees, salary or hourly, for out of pocket expenses that are incurred in order to maintain and complete their job assignments. This tax code applies to all employees and all employers of the United States and its Territories.

(iii) APPLICABLE LAW:

Section 61 of the Internal Code (Code) defines gross income as all income from whatever source derived. Section 62 defines adjusted gross income as gross income minus certain deductions. Section 62(a)(2)(A) provides that, for purposes of determining adjusted gross income, an employee may deduct certain business expenses paid by the employee in connection with the performance of work assignments as an employee of the employer under a reimbursement or other expense allowance arrangement.

Section(c) provides that, for purposes of Section 62(a)(2)(A), an arrangement will only be treated as a reimbursement or other expense allowance arrangement if (1) the arrangement does require the employee to substantiate the expenses covered by the arrangement to the person providing the reimbursement, or (2) the arrangement does not provide the employee the right to retain any amount in excess of the substantiated expenses covered under the arrangement.

Section 1.62-2(c)(1) of the Income Tax Regulations provides that a reimbursement or other expense allowance arrangement satisfies the requirements of Section 62(c) if it meets the requirements of business connection, substantiation, and returning amounts in excess of substantiated expenses. If an arrangement meets these requirements, all amounts paid under the arrangement are treated as paid under an accountable plan: Section 1.62-2(c)(2). Amounts treated as paid under an accountable plan are excluded from the employee's Form W-2, and are exempt from the withholding and payment of employee taxes: Section 1.62-2(c)(4).

An arrangement meets the business connection requirement of Section1.62-2(d) if it provides advances, allowances, or cash reimbursements for business expenses that are allowable as deductions by Part VI (Section 161 and the following), subchapter B, Chapter 1 of the Code, and that are paid or incurred by the employee in connection with the performance of services as an employee of the employer. Thus, not only must an employee pay or incur a deductible business expense, but the expense must arise in connection with performing services for that employer. If an employer reimburses deductible business expenses that the employee incurred prior to employment, the plan does not meet the business connection requirement.

Section 162(a) permits a deduction for ordinary and necessary expenses paid or incurred during the taxable year in carrying on a trade or business. Section 1.162-17(a) provides rules for the reporting and substantiation of ordinary and necessary business expenses incurred in connection with the performance of services as an employee. Section 1.162-17 further provides that the term "ordinary and necessary business expenses" means only those expenses which are ordinary and necessary in the conduct of the taxpayer's business and are directly attributable to such business.

Section 167(a) allows a reasonable allowance for the exhaustion, wear and tear, and obsolescence of property used in the taxpayer's trade or business to be taken as a depreciation deduction.

Section 179(a) permits a taxpayer to elect to treat the cost of any Section 179 property, as defined in Section 179(d)(1), as an expense in the year such property is placed in service, in lieu of treating the cost as chargeable to capital account subject to depreciation under Section 167. The cost is permitted as a deduction for the taxable year in which the Section 179 property is placed in service by the taxpayer.

Section 1.179-4(a) defines Section 179 property, in relevant part, as any tangible property described in Section 179(d)(1) that is acquired by purchase for use in the active conduct of the taxpayer's trade or business. The determination of whether property is used in the "active conduct of the taxpayer's trade or business" is made under Section 1.179-2(c)(6). For purposes of Section

1.179-2(c)(6) and 1.179-4(a), Section 1.179-2(c)(6)(i) provides that the term "trade or business" has the same meaning as in Section 162 and the regulations thereunder. Further, for purposes of Section 1.179-2(c)(6), Section 1.179-2(c)(6)(iv) provides that employees are considered to be engaged in the active conduct of the trade or business of their employment.

Section 1.62-2(e)(1) provides that the substantiation requirement is met if the arrangement requires each business expense to be substantiated in accordance with paragraph (e)(2) or (e)(3) of that section, whichever is applicable, to the payor (the employer, its agent or a third party) within a reasonable period of time. Section 1.62-2(g)(1) provides that what constitutes a reasonable period of time depends on the facts and circumstances of each arrangement. However, Section 1.62-2(g)(2) provides a safe harbor for substantiation under which the substantiation requirement is met if an expense is substantiated within 60 days after the expense is paid or incurred.

Section 1.62-2(e)(2) provides that an arrangement that reimburses expenses governed by Section 274(d) meets the requirements of Section 1.62-2(e)(2) if information sufficient to satisfy the substantiation requirements of Section 274(d) and the regulations is submitted to the payor. Section 274(d) applies to "listed property" under Section 280F(d)(4). The list is limited to items such as property used for transportation including an automobile, computer or peripheral equipment as defined in Section 168(i)(2)(B), and cellular telephone or similar telecommunications equipment. No deduction is allowed for an expense associated with such listed property under Section 274(d)(4), and any "reimbursement" of the expense must be treated as wages subject to withholding and payment of employment taxes, unless the employee establishes by adequate records (A) the amount of each expenditure, (B) the amount of each business or investment use of the listed property and its total use, (C) the date of the expenditure or use, and (D) the business purpose for an expenditure or use of any listed property: Section 1.274-5T(b)(6) and (f) and Section 1.274-5(f)(4).

Section 1.62-2(e)(3) provides that an arrangement that reimburses business expenses not governed by Section 274(d) meets the requirements of Section 1.62-2(e)(3) if information is submitted to the payor sufficient to enable the payor to identify the specific nature of each expense and to conclude that the expense is attributable to the payor's business activities. Each of the elements of an expenditure or use must be substantiated to the payor, and it is not sufficient for an employee to merely aggregate expenses into broad categories or to report individual expenses through the use of vague, non-descriptive terms.

Section 1.62-2(e)(3) references Section 1.162-17(b) which provides substantiation rules for employee business expenses. Section 1.162-17(b)(1) provides that an employee need not report on his tax return expenses for travel, transportation, entertainment, and similar purposes paid or incurred by him solely for the benefit of his employer for which he is required to account and does account to his employer and which are charged directly or indirectly to the employer, or for which the employee is paid through advances, cash reimbursements, or otherwise, provided the total amount of the advances, reimbursements, and charges is equal to the expenses. Section 1.162-17(b)(4) requires an employee to submit an expense account or other required written statement to the employer showing the business nature and the amount of all the employee's expenses.

Section 1.62-2(f) provides that an arrangement meets the requirement of returning amounts in excess of expenses if it requires the employee to return to the payor within a reasonable period of time any amount paid under the arrangement in excess of the expenses substantiated.

(iv) QUALIFIED REIMBURSEMENTS:

The employer will determine what job related items each employee, by job type (classification), is required to maintain and complete their respective job assignment. As an example, a security officer or a nurse does not require weather maps or teaching certifications to accomplish his/her job assignments, however a teacher may need this teaching tool and specific teaching certifications to complete his/her job assignment. Certain jobs require prerequisites such as professional or union memberships, access to cell phone or the internet, or required subscriptions of which all would be reimbursable under the TradeCheck 132(d) Working Condition Fringe Benefit Plan.

(v) SUMMARY

The TradeCheck 132(d) Working Condition Fringe Benefit Plan is compliant with the applicable Tax Code: satisfying the business connection, substantiation, and return of excess requirements of an accountable plan as required by applicable law. Accordingly, all payments made under the Plan in accordance with the terms of the Plan will be excluded from the employee's income and will not be wages subject to the withholding and payment of employment taxes such as Income Tax, Social Security and Medicare, along with Federal Unemployment (FUTA).

The methods and Plan rules are universal and apply to any business, within the United States of America and its Territories.

If you have any additional questions on this matter please feel free to contact my office. I have also enclosed a brief summary of my professional work experience over the past 46 years.

Sincerely,

Charles J. McLucas, Jr. CPA/PFS

Attentive Legal Framework

To Whom It May Concern:

At your request, we have prepared this document (this "Analysis") to outline the federal income tax framework relevant to a proposed wellness program to be offered to employers (the "Employers") adopting a self-insured medical expense reimbursement arrangement and premium-only structure (the "Wellness Plan"). This Analysis is based upon the factual representations contained in the materials provided by Attentive Health & Wellness ("Attentive"), including the Representation Letter attached hereto as Exhibit "A" (the "Representation Letter"), which form the basis for the factual assumptions referenced throughout this Analysis.

This Analysis is provided in connection with the documents and information referenced herein. The accuracy of the conclusions and explanations contained in this Analysis necessarily depends upon the correctness of the facts, assumptions, and representations as set forth in the Representation Letter and accompanying materials, and upon federal tax law in effect as of the date of this Analysis. This document addresses only the federal income tax considerations applicable to Employers implementing and funding the Wellness Plan under the circumstances described below.

I. PROPOSED TRANSACTION

A. <u>Description of the Proposed Transaction</u>

The Wellness Plan is a participation-based wellness plan with a monthly cost of participation. Costs are paid by employees on a pre-tax basis. The Wellness Plan consists of three (3) distinctive Plans:(1) An **ERISA**[1] based Wellness Plan,(2) A **Self-Insured Medical Expense Reimbursement Plan** (the "**SIMERP Plan**") under Section[2] 105, and (3) A **Premium Only Plan** (the "**POP Plan**") under Section 125. Each of these Plans operates concurrently to form the Wellness Plan and for reporting purposes may be part of a company-adopted wrap document. The Wellness Plan is integrated into the health plan under Section 105 and there is **no fixed indemnity plan** as part of the program.

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[1] "ERISA" means the Employee Retirement Income Security Act of 1974.

[2] References to "Section" or "§" herein refer to the Internal Revenue Code as of the date hereof, unless otherwise specifically stated.

B. Documents Reviewed and Relied Upon

In preparing this Analysis, we have reviewed and relied upon the information contained in the following documents, as provided to us by Attentive:

- Form of Section 125 Basic Plan Document, revision 2, dated July 2018;
- Form of Wellness Program Plan Document, version 6.1, effective July 1, 2018;
- The SIMRSP Master, revision 4, effective July 2, 2018;
- Form of Client Master Agreement, revision dated June 26, 2018;
- Form of Employer Understanding;
- Section 125 Cafeteria Plan Compliance Checklist;
- Nondiscrimination Summary for the Premium Only Plan;
- "The Costs of Noncompliance"; and
- Other materials included in the Representation Letter and supplemental documents provided by Attentive.

These materials form the factual basis upon which the explanations and analysis in this document have been prepared.

C. Assumptions

- (a) Based on the representations in the Representation Letter, the Employer has a self-insured health care reimbursement plan that is provided to all of its qualified employees.
- (b) Based on the representations in the Representation Letter, the Employer's self-insured health care reimbursement plan complies with the Affordable Care Act.
- (c) Based on the representations in the Representation Letter, any wellness incentives that do not meet the requirements under Section 213 will be reported as taxable payments on information returns.
- (d) Based on the representations in the Representation Letter, premium payments for the Wellness Plan will be used to fund qualifying medical expenses under Section 213, including health coaching programs, health monitoring programs, access to telehealth and teletherapy and couples counseling services.
- (e) Based on the representations in the Representation Letter, any incentive payments for the Wellness Plan that are not used to purchase non-taxable qualifying benefits will be reported as taxable income to the recipient.

II. BACKGROUND & FACTORS AFFECTING AVAILABILITY OF DEDUCTIONS FOR HEALTH CARE EXPENSES

A. History of Employer Health Plans

The tax favored treatment of health care expenses began during World War II when employers could not raise wages due to the 1942 Stabilization Act. Offering health benefits was a means to compete for employees without raising wages. The IRS ruled in 1943 that such benefits were not taxable. Then, as part of the 1954 Internal Revenue Code, Sections 105 and 106 were enacted, thus perpetuating the tax favored status of employer health plans.

There have been numerous criticisms of this tax subsidy since it favors those with higher incomes and it has been cited as a significant factor in the increasing costs of medical care. However, employer provided insurance is so widespread that it has been difficult to gain support for changing it. The Affordable Care Act (the "ACA"), passed in 2010, did scale back some of the benefits by imposing a range of new taxes such as the "Cadillac" tax for very generous plans. The ACA also added considerable complexity because of rulemaking that sought to curb employers from finding workarounds to the law.

However, Code Section 106(a) remains largely unchanged except for the addition of Health Savings Accounts and some provisions regarding restrictions related to the ACA.

B. History of Wellness Programs

While the concept of "wellness" has a long history, in the United States the idea of wellness dates from the 1950s and 1960s with the publication of Prevention magazine and the work of Dr. Halbert L. Dunn who published *High-Level Wellness* in 1961. Although Dunn's work received little attention initially, his ideas were later embraced in the 1970s by Dr. John Travis, Don Ardell, Dr. Bill Hettler, and others. These "fathers of the wellness movement" developed models of wellness, assessment tools, and actively promoted the concept by writing and speaking about it. Travis, Ardell, Hettler and their associates were responsible for creating the world's first wellness center, developing the first university campus wellness center, and establishing the National Wellness Institute and the National Wellness Conference in the U.S.

In the succeeding decades, the wellness movement gained momentum. Others such as Tom Dickey and Rodney Friedman continued the work by establishing the monthly *Berkeley Wellness Letter* in 1984, designed to compete with the *Harvard Medical School Health Letter*, pointedly using "wellness" in the title as a construct. In 1991, the U.S. National Center for Complementary and Alternative Medicine was established, as part of the government-funded National Institutes of Health.

By the 2000s, workplace wellness programs were established and the culture embraced spas, fitness centers, etc. As costs for health care continued to escalate, more employers embraced "wellness." By 2014, according to the Buck Consultants report, more than half of global employers were using health promotion strategies, with a third of those having full-blown wellness programs.

C. Internal Revenue Code Provisions Regarding Health Care

Section 105

In general, Section 106(a) provides that gross income of an employee does not include employer-provided coverage under an accident or health plan. Under Section 105(b), an employee generally may exclude from income amounts received through employer provided accident or health insurance if those amounts are paid to reimburse expenses incurred by the employee for medical care (of the employee, the employee's spouse, or the employee's dependents) for personal injuries and sickness. Section 105(h) provides that the exclusion of Section 105(b) does

not apply to self-insured medical reimbursement plans that discriminate in favor of highly compensated employees with respect to eligibility to participate and benefits.

Section 125

Generally, an employee choice between two or more benefits consisting of taxable benefits such as cash and nontaxable benefits such as employer-provided health coverage results in a cafeteria plan the taxable benefits under which are included in income unless the choice is provided in accordance with the rules under Section 125.

Under Section 125, an employer may establish a cafeteria plan that permits an employee to choose among two or more benefits, consisting of cash (generally, salary) and qualified benefits, including accident or health benefits. Pursuant to Section 125, the amount of an employee's salary reduction applied to purchase employer-provided health coverage is not included in gross income, even though it was available to the employee and the employee could have chosen to receive cash instead. If an employee elects salary reduction pursuant to Section 125, the coverage is excludable from gross income under section 106 as employer-provided accident or health coverage.

Section 213(d)

Section 213(d) sets forth a list and description of expenses that are eligible deductible medical expenses. "Medical care," under Section 213(d), means, among other things, amounts paid "for the diagnosis, cure, mitigation, treatment or prevention of disease, or for the purpose of affecting any structure or function of the body." "Medical care" also includes amounts paid for medical insurance.

D. Limited IRS Guidance Regarding Wellness Plans

The IRS issued three Chief Counsel Advice Memoranda ("CCAs") in 2016 and 2017 addressing aspects of wellness programs and incentives. CCAs are IRS internal legal advice based on specific facts and are not binding precedent; however, their analysis is useful for applying the Internal Revenue Code and its regulations to similar factual scenarios. The CCAs are summarized below:

1. CCA201622031 dated April 14, 2016:The issue in this CCA was whether cash rewards for participating in a wellness program could be excluded from an employee's taxable income under Sections 105 or 106 and also whether reimbursement of premiums could be excluded from income if the original premiums were paid pre-tax under a Section 125 plan.

The IRS concluded that such payments could not be excluded from income because "any reward, incentive or other benefit provided by the medical program that is not medical care as defined under Section 213(d) is included in an employee's income, unless excludable as an employee fringe benefit under Section 132."
Therefore, only de minimis fringes can be excluded (for example a T-shirt).

The IRS further concluded that under Rev. Rul. 2002-3 (2002-3 I.R.B. 316) the reimbursement of the employee's premium was taxable because the premium had been paid pre-tax under a Section 125 plan.

2. CCA201719025 dated April 24, 2017: The issue in this CCA was whether benefits paid under an employer-provided self-funded health plan are included in wages if the average amount received by the employees predictably exceeds the after-tax contribution by the employee.

The IRS concluded that the benefits were taxable for two reasons (either of which is sufficient to disqualify the benefits from tax-favored treatment). First, the IRS found that the employer's self-funded health plan does not involve insurance risk and thus does not have the effect of insurance for federal income tax purposes (citing Section 104(a)(3)).

The second reason was that, essentially, under an actuarial analysis, the employees were expected to receive benefit payments under the self-funded health plan that **"markedly" exceeded their after-tax premium payments (by $16,380 per year).**
The IRS views this arrangement as a means to avoid FICA taxes.

There were two different factual situations analyzed in the CCA. In the first situation, there was employer premium paid to a self-funded health plan. The amounts to be awarded under this plan were much greater than the premium amount. The IRS found that the arrangement was not qualified for exclusion from income under Section 104 because it did not involve risk shifting and did not meet the definition of insurance.

In the second factual situation, there was a wellness plan that qualified as an accident and health plan under Section 106 and it was coupled with a self-funded health plan. The premiums were paid pre-tax under a Section 125 plan.

The employee was then awarded flex credits under the Section 125 plan which could be used to purchase other benefits. Under this second factual situation, the IRS found that the flex credits would not be taxable if they were used for non-taxable qualifying benefits (such as group term life insurance) but would be taxable if used to purchase taxable benefits such as gym memberships or whole life insurance coverage.

3. CCA201703013 dated December 12, 2016: This CCA addressed whether payments received by an employee from an employer under a fixed indemnity health plan or a wellness plan were excludable from the employee's income under Section 105.

The IRS held that, on the one hand, when the premiums for a fixed indemnity health plan or a wellness plan are paid from pre-tax dollars, the exclusions under Sections 105(b) and 104(a)(3) do not apply and any payments are included in the employee's gross income and wages. On the other hand, the IRS held that when premiums for a fixed indemnity health plan are paid with after-tax dollars, amounts paid by the plan are excluded from gross wages under Section 104(a)(3).

In part of the analysis particularly relevant to Attentive, the CCA states: "The value of coverage by an employer-provided wellness program that provides medical care (as defined under §213(d)) generally is excludable from an employee's gross income under §106(a), and any reimbursement or payments for medical care (as defined under §213(d)) provided by the program is excludable from the employee's gross income under §105(b)."

E. Analysis of the Wellness Plan and Limitations

The Wellness Plan follows the long-standing development of employer wellness initiatives by enabling Employers to offer wellness-related benefits to their employees through a self-insured medical expense reimbursement structure. Employees who enroll in the Wellness Plan participate pursuant to the Program documents adopted by the Employer, and reimbursements are made only for qualified medical care expenses as defined in Section 213(d). Section 105 governs whether reimbursements paid under a self-insured medical reimbursement arrangement are includable in or excludable from an employee's income. Under the Wellness Plan, employees engage with the Program's wellness components, and any reimbursements are issued in accordance with substantiated deductible medical expenses as described in the Program documents and the applicable provisions of Treas. Reg. §1.105-11, rather than through fixed-amount or indemnity-style payments (cf. CCA 201703013).[1]

Based on the structure described in the Program documents and the representations set forth in the Representation Letter, the Wellness Plan is administered as a voluntary wellness-oriented medical reimbursement arrangement under which employees may obtain supplemental wellness benefits when they satisfy the participation and substantiation requirements established under the Wellness Plan. Reimbursement payments made pursuant to properly substantiated Section 213(d) expenses align with the exclusion provided under Section 105(b). This Analysis is based solely on the documents and representations provided by Attentive and on current federal tax law and administrative guidance in effect as of the date of this Analysis. This Analysis is provided for informational purposes and summarizes the federal tax framework applicable to the Wellness Plan based on the documents and representations supplied. It is not intended to serve as a legal or tax opinion and should not be construed as binding guidance on any regulatory authority.

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[1] Although here, as in CCA201719025, the excess annual actuarial value for the benefits received by the employees exceeds the premiums paid, the CCA can be distinguished insofar as the payments were deemed taxable in Situation 2 only to the extent that they were used to purchase taxable benefits.

F. Conclusion

Based on the structure of the Wellness Plan and the materials provided by Attentive, the Wellness Plan is designed as a self-insured medical expense reimbursement arrangement that reimburses employees only for qualified medical care expenses under Section 213(d). The Wellness Plan requires substantiation for all reimbursable expenses, avoids fixed-amount or indemnity-based payments, and follows the administrative standards set forth in Sections 105, 106, and 125, as well as the supporting Treasury Regulations.

The Wellness Plan reflects the long-standing model of employer-sponsored wellness and medical reimbursement programs that have been recognized under federal tax law for many years. The documents reviewed describe procedures and safeguards intended to support compliance with these requirements, and the structure of the Wellness Plan is consistent with the framework applicable to self-insured wellness reimbursement arrangements.

This Analysis summarizes how the Wellness Plan aligns with the federal tax rules governing employer-provided medical benefits and is intended to help Employers understand the regulatory foundation on which the Program is built. Employers may find it helpful to review this Analysis with their own advisors to determine how the Wellness Plan fits within their overall benefits strategy.