

## **Section 105 – Medical Reimbursement Plan for Employers**

### **What is a Medical Reimbursement Plan? (MERP)**

A medical reimbursement plan (MERP) is any plan or arrangement under which an employer reimburses an employee for uninsured health or accident expenses incurred by the employee or their dependents. Health or accident expenses are defined in IRC Section 213(e). If done correctly, these reimbursements are paid to the employee tax-free.

**Note:** *An MERP is NOT a Section 125 plan, Cafeteria Plan, or Flexible Spending Plan. Differences include the fact that these plans are more complicated to administer, they are employee funded through salary reduction, and they are characterized as a use-it-or-lose-it type of plan.*

### **Why would a Employer Adopt a Medical Reimbursement Plan?**

An MERP is a form of self-insurance. An employer can use an MERP as a way to lower medical insurance costs but still cover the employees' qualified medical expenses tax-free. In a year when the cumulative medical costs for employees are relatively low, the savings on insurance costs can be quite significant. On the other hand, in a year of high medical costs, medical reimbursements could be higher than insurance premiums saved. If a church reduces medical insurance coverage in order to lower premiums without adding a MERP, that employer is simply shifting medical expenses from employer to employee. In addition, the employee could then be forced to pay their higher medical expense using after-tax funds. The MERP helps avoid that added cost to the employee.

### **How Does a Medical Reimbursement Plan work?**

1. The employer must establish a formal written plan. (See sample plan document attached.) Note that this benefit is for employees only and is employer funded. It cannot be funded by any means of salary reduction.
2. The employer determines the amount available in each employee's personal account for the coverage period (generally a year). The employer can establish a dollar limit per employee. The employer also determines how much of that amount can be rolled over to future coverage periods and determines whether former employees can access untapped MERP funds.
3. As eligible expenses are submitted, the employee's personal account is reduced and paid to them on a nontaxable basis.
  - a. Expenses must be submitted using adequate claim substantiation.
  - b. The expenses claimed cannot be reimbursed by any other plan.
  - c. Only qualified expenses may be reimbursed (IRC Section 213)
  - d. Claims must be only for those expenses incurred during the coverage period.
  - e. Reimbursement for payments of medical insurance premiums may be included.
4. Unused funds at the end of the year are carried over to the next year. At the beginning of the next coverage period, additional funds are added. This leaves funds from a low medical cost period available for use in a higher cost period. With no "use-it-or-lose-it" requirements, employees have an incentive to be responsible managers of the MERP balances.

### **What are the non-discrimination requirements?**

The plan must not discriminate in favor of highly compensated employees with respect to eligibility to participate or benefits provided under the plan.