



# Tobacco surcharges: wellness program compliance considerations

## An employer guide to health-contingent insurance premiums

A popular plan design for employers looking to encourage a healthy lifestyle in their employees is the use of a tobacco surcharge. A tobacco surcharge is a permissible part of a bona fide wellness program that allows employers to charge tobacco users higher premiums than their counterparts who do not use tobacco.

Recently, there has been an increase in litigation regarding improper use of tobacco surcharges in group health plans. Employers should be cautious about tobacco surcharges and make sure that they are implementing the programs properly to avoid costly litigation and ensure fair participation for all employees.

## Requirements for a Health-Contingent Tobacco Surcharge

The implementation of a tobacco surcharge is considered a “health-contingent” wellness program. Health-contingent programs are divided into two categories: activity-only and outcome-based.

- An activity-only program is one that requires the individual to perform or complete an activity related to a health factor to obtain the wellness reward. The person simply needs to complete the activity, rather than to achieve specific results, to receive the reward.
- An outcome-based program requires the individual to achieve or maintain a specific health outcome, such as not using tobacco. The nature of implementing a tobacco surcharge typically makes the program outcome-based.

There are a number of requirements that an outcome-based wellness program needs to meet. The program must:

1. Be reasonably designed to promote health or prevent disease;
2. Give employees a chance to qualify for the incentive at least once a year;
3. Cap the reward or penalty at 50% of the total cost of coverage for avoiding tobacco (this is the total cost of coverage, not just the employee-portion);
4. Provide an alternative way, or reasonable alternative standard, to qualify for the incentive;
5. Describe the reasonable alternative standard of qualifying for the incentive in written program materials.

## The Reasonable Alternative Standard — A Common Area of Concern

At first glance, a tobacco surcharge can be attractive to employers because it gives a tangible and costly incentive to employees to practice a healthy lifestyle and quit smoking. These types of programs have strict regulations, however, and employers need to ensure they are following the rules for properly implementing a tobacco surcharge, specifically when it comes to administering the reasonable alternative standard.

For most tobacco surcharges, the reasonable alternative standard is the completion of a tobacco cessation course or program. Employers should note that completion of the reasonable alternative standard is required to qualify the participant for the entire incentive. This means that if a

participant completes a tobacco cessation course but does not quit smoking, the participant is still eligible to remove the tobacco surcharge for the plan year.

The employer or wellness program cannot have an additional requirement on top of the reasonable alternative standard that requires an employee to stop using tobacco products. The reasonable alternative standard on its own is enough to qualify for the benefit.

Participants who complete the reasonable alternative standard (such as a tobacco cessation course) are considered eligible for the surcharge removal for the entire applicable plan year. This means that the employer must retroactively reimburse the employee for the entire amount of the tobacco surcharge charged throughout the plan year.

The rules require that participants have an opportunity to complete the reasonable alternative standard at least once a year. For most programs, this means that the participant must complete a tobacco cessation course designated by the wellness program (and get proper certification).

Employers could run into issues with this requirement in situations where the time frame to complete the tobacco cessation course is too short (i.e., needing the course to be completed within one month of the plan year starting) or if they do not give new hires who start in the middle of the plan year the opportunity to complete the reasonable alternative standard. Plans should be designed so that participants have sufficient time within the plan year to complete the reasonable alternative standard, regardless of when their benefits start.

## Tobacco Surcharges and the ACA

Under the Affordable Care Act (ACA), tobacco surcharges are the only wellness program that the employer can consider when determining affordability of its health plan for the applicable plan year. With a tobacco surcharge, the employer can assume that all employees will complete the reasonable alternative standard and therefore be eligible for the benefit for the entire plan year. The employer does not have to include the amount of the tobacco surcharge in the affordability calculation.

This is the only type of wellness program that this rule applies to. For all other wellness programs with financial incentives, employers cannot factor reimbursements into the affordability calculation.

## Practical Considerations for Tobacco Surcharges

Many employers have concerns that requiring an attestation to receive a tobacco-use incentive is not enough to stop smoking or other tobacco-use in their employee population. Employers may have concerns that people are not honest about their tobacco use, or that an employee may complete a tobacco cessation course with no intention of quitting tobacco products.

These are valid concerns, but employers ultimately cannot control these issues. If an employee is caught lying on their tobacco attestation for a certain plan year, the employer is limited to the recourse in its written wellness plan policy, its employee handbook or in their other policies regarding employee dishonesty. The employer cannot retroactively change an employee's premiums for the plan year if the employee is caught lying.

It is also likely that some employees will not stop using tobacco products after taking a tobacco cessation course. In these instances, the employee may complete the reasonable alternative standard every plan year and, for the next plan year, attest that they still use tobacco, thus becoming subject to the surcharge until they complete the

## Example

Tony is the owner of a local taco restaurant, Tony's Tacos, and he notices that a large portion of his employee population is composed of tobacco users. Tony decides to implement a tobacco surcharge through a wellness program on his health plan. A former smoker himself, Tony does not think that tobacco cessation courses are a strong enough incentive to stop smoking, so he decides that he will do nicotine swab tests on random employees throughout the year and remove the tobacco surcharge from the premiums of those who pass the tests.

This is not a permissible practice. Tony needs to implement a reasonable alternative standard to receive the tobacco surcharge removal, which can include taking a tobacco cessation course. Tony cannot additionally require that employees actually stop using tobacco products to receive the award.

reasonable alternative standard for that plan year. The employer cannot limit the employee's ability to complete the reasonable alternative standard if the employee refuses to quit smoking or using tobacco.

## Increase in Tobacco Surcharge Litigation – A Warning to Employers

Starting in fall 2024, a number of class-action lawsuits have been filed against large corporations regarding improper use and implementation of tobacco surcharges in group health plans. Some of these lawsuits have been filed by the same law firms, indicating that law firms may be “recruiting” clients for suitable lawsuits against large employers. While the claims in these lawsuits vary to fit the facts and circumstances of the defendant, they all claim that an employer has improperly utilized tobacco surcharges in its health plan(s).

Some of these lawsuits claim that the employees only receive the benefit on a “going-forward” basis, when they should receive the benefit retroactive for the entire plan year. Others argue that the reasonable alternative standard was not followed or that the defendant implemented a secondary step to the reasonable alternative standard (such as requiring an employee to quit smoking) in order to receive the benefit. Still others argue that the total amount of the tobacco surcharge exceeds the permitted amount of 50% of the total cost of the benefit.

Employers should therefore be aware of the rise in popularity of tobacco surcharge litigation and make sure they review their wellness plans regularly to ensure compliance.

For more information, contact your Alera Group consultant.

