AssuredPartners

Tobacco Surcharges

January 2025

Many employers provide incentives to employees (and sometimes their family members) for not smoking or using tobacco products to encourage them to adopt healthier lifestyles and to potentially cut down on medical costs. However, some employers fail to realize that putting such incentives in place may be considered a wellness program subject to HIPAA and EEOC wellness rules. Employers choosing to use a tobacco-related incentive must be mindful of requirements such as incentive limits and reasonable alternative standards (RAS), as well as confidentiality notices if medical testing is involved.

Background

A wellness program with incentives tied to a group health plan (e.g., reductions in medical premiums or cost-sharing) must meet certain requirements to avoid violating HIPAA nondiscrimination rules. Such programs generally have to comply with requirements including, but not limited to, having limits on incentives and offering an RAS. Most often, tobacco-related incentives are tied to the group health plan and are therefore considered health-contingent programs subject to HIPAA wellness rules.

A wellness program that requires an employee to undergo medical testing or give responses to disability-related questions to earn incentives must meet certain requirements to avoid violating the Americans with Disabilities Act (ADA). EEOC rules require such programs to comply with incentive limits, confidentiality and disclosure requirements, and more. EEOC wellness rules need to be considered for tobacco-related wellness programs only if medical testing (e.g., saliva or blood samples) is used to verify nicotine or tobacco use.

Types of Tobacco-Related Incentives

Employers can choose to incent employees not to smoke or use tobacco products in a variety of ways. The most common options include: (i) HSA, HRA or FSA contributions; (ii) a decrease in employee contributions toward medical coverage (often referred to as a tobacco surcharge); and (iii) cash, gift cards or entries into a prize drawing.

If the incentive does NOT affect the group health plan (e.g., cash, gift cards, prize drawing, HSA contributions), then HIPAA wellness rules do not apply. In other words, there would be no limit on the incentive unless medical testing were involved (in which case, the EEOC rules would impose a separate incentive limit). In addition, it would not be necessary to offer an RAS.

However, for tobacco-related incentives, employers are more likely to tie the incentive to a group health plan, often imposing a tobacco surcharge on the monthly employee contribution for medical coverage. For such

incentives, HIPAA wellness rules apply, including the 50% incentive limit and the requirement to offer an RAS to earn the incentive. The HIPAA incentive limit and the requirement to offer an RAS are discussed further below.

HIPAA Incentive Limit

If the incentive affects the group health plan, HIPAA wellness rules set a tobacco-related incentive limit of 50% of the total cost of coverage (employer and employee contributions combined). If the incentive is applicable only to the employee, the incentive limit is calculated based on the cost of single coverage. However, if both the employee and the spouse are eligible to earn the incentive, the incentive limit is calculated based on the cost of whichever tier of coverage the employee and spouse enroll in. NOTE: If the employer offers both non-tobacco and tobacco-related incentives, then the total combined incentives subject to HIPAA cannot exceed the 50% incentive limit (non-tobacco-related incentives capped at 30%).

Example - Employer offers a mix of non-tobacco-related and tobacco-related incentives tied to the group health plan, but no medical testing is involved (therefore EEOC rules do not apply).

	Single	Family
Monthly premium	$450	$1,200
Maximum non-tobacco-related incentives (30%) – difference permitted in employee contribution	$135	$360
Maximum non-tobacco and tobacco-related incentives (50%) – difference permitted in employee contribution	$225	$600

Most employer wellness program incentives do not come anywhere near the incentive limits outlined above. Typically, only those employers choosing to provide significant incentives have to be careful. That being the case, tobacco-related incentives do tend to be the most aggressive.

Incentive Limits Under the ADA and GINA (EEOC Wellness Rules)

Employers offering wellness programs subject to the ADA and/or GINA must consider incentive-related issues when participation involves medical testing, disability-related questions, or the disclosure of genetic information. Given the absence of clear EEOC guidance on incentive limits applicable to these programs, some employers may choose to align with HIPAA's established limits, while others may opt for a more cautious approach with lower incentive amounts to ensure compliance.

HIPAA Reasonable Alternative Standard (RAS)

The most common issue for tobacco-related incentives is that employers fail to offer an RAS, fail to provide notice of such standard, or fail to provide the full reward to those who satisfy the RAS. Again, assuming that the incentive affects the group health plan, HIPAA wellness rules require that those who do not satisfy the original standard (e.g., tobacco users or smokers) must be offered an opportunity to earn the full incentive by satisfying a RAS.

The employer has some flexibility in setting an RAS, but simply providing additional time to satisfy the same standard (e.g., stop using tobacco or smoking) is not compliant. In addition, guidance indicates that the individual must be provided with the full incentive following completion of the RAS, regardless of whether the individual actually stops using tobacco. There must be an annual opportunity to receive the incentive, either as a non-tobacco user or by satisfying the RAS. For example, a tobacco user could earn the incentive each year by annually completing a tobacco cessation course. Although employers sometimes find this frustrating, consider that these individuals still have to take extra steps to earn the incentive and must do so annually.

Taking a tobacco cessation class and/or using tobacco cessation products are common options provided as an RAS. The employer should provide a period of time for completion of the RAS and then provide the full incentive available to non-tobacco users for those who satisfy the requirement. If tobacco cessation classes are offered as the RAS, they must be provided at no cost. The regulations indicate that if the RAS is the completion of an educational program, the plan or issuer must make the program available or assist the employee in finding such a program and cannot require the individual to pay for the cost of the program. Tobacco cessation classes and/or counseling can be found and are often provided at no cost through state-run programs. The time commitment must also be reasonable. If there is an option to use tobacco cessation products for a period of time, there is not the same requirement to cover the cost; but some coverage for tobacco cessation may be provided under the medical plan as preventive coverage.

RAS Notice Requirement

Employers with tobacco surcharge programs subject to HIPAA and the RAS requirement must notify participants of the RAS availability. Employers are required to disclose the availability of a RAS to qualify for the reward (and, if applicable, the possibility of waiver of the otherwise applicable standard) in all plan materials describing the terms of a health-contingent wellness program. However, if plan materials merely mention that such a program is available without describing its terms, the RAS notice is not required to be included in those materials. For example, an SBC that mentions cost-sharing may vary based on participation in the wellness program, without describing the standards of the program, would not trigger the notice. In contrast, a plan disclosure that references a premium differential based on tobacco use, is a disclosure describing the terms of a health-contingent wellness program and, therefore, must include the RAS notice.

The regulations clarify that the notice must include contact information for obtaining the alternative and a statement that recommendations of an individual's personal physician will be accommodated. The contact person could be another employee, such as the employer's "Benefits Director" or third-party such as the wellness vendor. The employer will need to ensure the contact information remains current.

Tobacco Surcharge Litigation

Recent litigation regarding tobacco surcharge programs has seen a significant increase, with several class action lawsuits targeting large corporations. Many of these lawsuits allege similar HIPAA violations centered around the failure to provide, notify, and/or correctly administer a tobacco surcharge program's RAS. A few examples of these class action lawsuits are included below.

Whole Foods - In January 2025, several current and former Whole Foods employees filed a class action lawsuit alleging that Whole Foods' tobacco surcharge program fails to offer the requisite RAS because it does not offer the

full reward to participants who complete the RAS. The lawsuit alleges that the program provides a refund of surcharge payments only prospectively after completion of the RAS instead of refunding the surcharge retroactively back to the start of the program year. Plaintiffs also allege that proper disclosure of the program and its details were not provided. Litigation is still ongoing.

Bass Pro Shops – A class action filed in 2024 alleged Bass Pro Shop's wellness program, which included a tobacco surcharge, violated HIPAA's rules for outcome-based wellness programs by failing to meet the safe harbor requirements necessary to impose such a surcharge. Specifically, the complaint states that the program failed to provide participants who were not tobacco-free with an RAS to avoid the surcharge and failed to notify participants of the availability of an RAS in plan materials. Bass Pro Shops agreed to a $4.95 million settlement in 2025.

Macy's – In 2017, the U.S. Department of Labor (DOL) filed a lawsuit against Macy's, Inc. and its Welfare Benefits Plan, alleging that the company's tobacco surcharge violated HIPAA's wellness program rules. The DOL claimed that the wellness program offered a smoking cessation program, but avoidance of the surcharge was conditioned on the participant being smoke-free at the end of the cessation program and therefore did not provide an RAS to being a non-smoker. As of January 2025, litigation is still ongoing.

Impact of *Loper Bright*

The Supreme Court's decision in *Loper Bright* could have significant implications for tobacco surcharge litigation, particularly in the context of administrative agency regulations and judicial deference. Defendants in several tobacco surcharge lawsuits have argued that following the *Loper* decision, the court is not required to follow the agency's interpretation of the wellness regulations and instead must follow the court's own interpretation of the applicable statute. The current impact of the *Loper* decision is unclear and won't be realized until existing court challenges are resolved.

Specific Considerations for a Tobacco Surcharge

For employers using a tobacco surcharge on employee contributions, a decision needs to be made about how to handle the surcharge for those who are tobacco users but then satisfy the RAS. Below are a few potential options:

1. Require completion of the RAS prior to the beginning of the plan year (at least for those already employed).
2. Offer the lower employee contribution and impose the surcharge prospectively for those who fail to complete the RAS.
3. Offer the lower employee contribution and impose the surcharge retroactively (and prospectively) for those who fail to complete the RAS.
4. Impose the surcharge and return the money as additional taxable compensation for those who complete the RAS (the lower employee contribution would be charged prospectively).

Option 3 is the most problematic because it may be difficult to collect the surcharge retroactively. And although §125 rules would clearly allow a prospective adjustment to pre-tax elections made through a cafeteria plan due to a

change in the cost of coverage, it is not clear that a retroactive change would be permitted (in other words, it might be necessary to collect retroactively on an after-tax basis).

It is also necessary to consider how the tobacco surcharge may impact affordability for applicable large employers (50 or more FTEs) subject to §4980H employer shared responsibility rules. For wellness incentives that affect the employee contribution toward medical coverage, the general rule of thumb is that the non-wellness rate (the higher rate) must be used for purposes of determining affordability. However, for a tobacco-related incentive, the rules permit an employer to use the non-tobacco rate to determine affordability.

Example - Required monthly employee contribution is $250/month, and wellness incentive reduces the employee contribution to $150/month.

- If the incentive is NOT tobacco-related, coverage is "affordable" so long as $250 does not exceed 9.02% (in 2025) of employee's household income. $250.00 should be entered on Line 15 of Form 1095-C.
- If the incentive is tobacco-related, coverage is "affordable" so long as $150 (not $250) does not exceed 9.02% (in 2025) of employee's household income. $150.00 should be entered on Line 15 of Form 1095-C.

Enforcement

Some employers simply use an employee attestation/affidavit certifying tobacco use or lack thereof, while others have taken it a step further and require medical testing. If the employer is using an affidavit/attestation (taking the employee's word) versus performing medical testing to confirm use, some decisions need to be made about how much the employer wants to actively police whether employees were truthful on the affidavit. Keep in mind that some states have laws prohibiting employers from considering employee actions outside of work. A few things to consider for the affidavit:

- Clarify the definition of smoking and/or tobacco use. For example, are e-cigarettes included?
- Clarify whether the employee is indicating tobacco use currently, for a previous period, for a future period, or all three.
- Communicate the repercussions of falsification. For example, indicate whether the surcharge will be imposed retrospectively, or only prospectively, or whether coverage may be terminated (retrospectively or prospectively).

Whatever is decided, it would be advisable to have the affidavit reviewed by legal counsel to ensure that it correctly communicates the employer's intentions and enables the employer to enforce said intentions.