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Retiree HRAs and the ACA – Doing It Right

Now that the Supreme Court has affirmed that premium subsidies are available in all public marketplaces, more employers may want to transition their pre-Medicare retirees to marketplace coverage — and provide them with financial assistance to help pay for the coverage or to offset some of the cost-sharing burden. Not only may this approach reduce ongoing costs, but it may also help mitigate or eliminate the Cadillac tax on retiree coverage. Employers that want to provide financial assistance through health reimbursement arrangements will need to proceed carefully to avoid potentially unwelcome consequences.

Background

Under the ACA, individuals not yet eligible for Medicare may purchase coverage through the public marketplace. If they satisfy certain eligibility requirements, they may receive a subsidy in the form of a premium tax credit to help them pay for the cost of that coverage.

Some employers would like to take advantage of the availability of marketplace coverage to reduce the cost of providing health coverage to their pre-Medicare retirees. Instead of providing coverage through their own plans, they want the retirees to purchase coverage through the public marketplace; the employer will furnish them with funds through a health reimbursement arrangement to offset the cost of the coverage. Employers contemplating doing this need to be aware of some of the significant issues that arise under this approach.

Health Reimbursement Arrangements

Health reimbursement arrangements (HRAs) are employer-funded accounts that employees and retirees can use for reimbursement of qualifying healthcare expenses. HRAs are group health plans, and to the extent that they reimburse medical expenses, generally must comply with the ACA's market reforms, such as the prohibition on annual dollar limits and, for non-grandfathered HRAs, the mandate to provide first dollar coverage of certain preventive services. Sponsors of HRAs that do not comply with ACA market reform mandates may be subject to excise taxes of $100/day under Section 4980D of the Internal Revenue Code. (See our February 28, 2014 *FYI In-Depth*, and our July 8, 2014 and November 19, 2014 *For Your Information* publications.)

HRAs “integrated” with other group health plan coverage that satisfies the ACA market reform mandates are deemed to comply with those requirements. (An HRA is integrated with a group health plan for purposes of ACA compliance if it can only be used to reimburse cost-sharing or premiums under that group health plan. This includes a group health plan maintained by another employer.) However, HRAs cannot be integrated with individual health coverage, including coverage obtained through the public marketplace.

Retiree-Only HRAs

Group health plans with fewer than two participants who were active employees on the first day of a plan year are exempt from the ACA market reforms for that year, although they still may be subject to other ACA provisions (see box at right). Because they are not subject to the market reforms, “retiree-only HRAs” do not have to be integrated with other group health plan coverage and may be used by retirees to help pay for premiums or other costs related to individual marketplace coverage.

What ACA requirements apply to retiree-only HRAs?

- Reporting of minimum essential coverage (6055 reporting generally only for pre-Medicare retirees and dependents)
- Comparative effectiveness research institute (PCORI) fee
- Transitional reinsurance fee (generally only for pre-Medicare retirees and only if it provides 60% minimum value)
- “Cadillac” excise tax

> **Comment.** Some employers allow retirees to return to work on a temporary or part-time basis. Because these retirees would now be “active” employees, their continued participation in an intended retiree-only plan risks loss of that status.

There are no clear rules for establishing that a retiree plan is "retiree-only." Proposed regulations under the 2004 HIPAA portability rules state that there is a general presumption that an employer provides all medical benefits through one group health plan. However, this presumption can be rebutted where: (1) it is clear from the instruments (e.g., plan documentation) governing the arrangements that the benefits are being provided under separate plans, and (2) the arrangements are operated pursuant to the instruments as separate plans.

Indicia that a plan is “retiree-only” and separate from a plan covering active employees include separate:

- Plan documents/SPDs
- 5500 filings
- Funding mechanisms and carrier contracts
- Administration

No one element is determinative of retiree-only status — for example, the fact that an employer files one Form 5500 for the active employee plan and the retiree plan would not necessarily preclude the retiree plan from being treated as “retiree-only.” However, the greater the number of separate elements, the easier it is to support separate plan status.

Court decisions on retiree-only exemption

To date, at least one court has recognized the retiree-only exemption. Earlier this year, in *King v. Blue Cross Blue Shield of Illinois*, the federal trial court found that a retiree-only plan sponsored by United Parcel Service did not violate the ACA by having a $500,000 lifetime limit on medical benefits. However, the decision did not include any analysis as to whether the plan qualified as retiree-only.

Comment. Many employers treat HRAs as notional accounts and do not maintain them pursuant to written plan documents. To help establish an HRA's status as a retiree-only plan (and to satisfy ERISA requirements if the HRA is subject to ERISA), an employer should adopt separate plan documents for the retiree HRA and for any other HRA that it maintains for active employees.

Retiree-Only HRAs and Premium Tax Credit Eligibility

Retirees purchasing coverage in a public marketplace may be eligible for premium tax credits that will help reduce their out-of-pocket costs if they satisfy certain conditions.

Income requirement

Like other individuals seeking a premium tax credit, a retiree's household income for the calendar year must be at least 100% of the federal poverty line (FPL) for his or her family size, but not more than 400% of such FPL. For individuals residing in states that have adopted the ACA's Medicaid expansion, eligibility for the tax credits generally begins at 138% of the FPL because the individual will qualify for Medicaid (and therefore be ineligible for tax credits) at lower income levels.

What is "household income?"

An individual's household income for a calendar year is the aggregate modified adjusted gross income (MAGI) for all members of his or her household who are required to file a tax return.

MAGI is adjusted gross income (as shown on line 37 of 2014 IRS Form 1040), increased by the following items to the extent they are tax-excludable:

- Foreign earned income
- Interest
- Social Security benefits

FPLs are determined annually by HHS and vary by household income and family size. The FPLs used for determining eligibility for a premium tax credit are the FPLs for the 48 contiguous states and the District of Columbia issued for the preceding calendar year. The following chart sets out the FPLs for 2014 that are used for determining eligibility for tax credits in 2015:

FPL Level	Single Person	Family of Two	Family of Four
100% FPL	$11,670	$15,730	$23,850
200% FPL	$23,340	$31,460	$47,700
300% FPL	$35,010	$47,190	$71,550
400% FPL	$46,680	$62,920	$95,400

Comment. Many retirees will have household income within the prescribed range and be eligible for premium tax credits on this basis. However, retirees in their calendar year of retirement or those with working spouses may have too much income to qualify.

Not enrolled in other minimum essential coverage (MEC)

Unlike active employees, who cannot receive premium tax credits for any month in which they are eligible for employer coverage that is affordable and provides minimum value (even if they aren't enrolled), retirees lose eligibility for the premium tax credit only if they are actually enrolled in employer-sponsored MEC. A retiree who has access to HRA funds to pay for marketplace premiums, cost-sharing or any other medical expenses is considered to be enrolled in employer-sponsored MEC and thus not eligible for premium tax credits. This is the case even if the retiree doesn't submit any expenses for reimbursement.

Do the ACA employer shared responsibility assessments apply to retirees who enroll in marketplace coverage?

No. The employer assessments only apply to full-time active employees who enroll in marketplace coverage and receive a premium tax credit.

In many instances, the value of the premium tax credits to the retiree may exceed the value of the amounts that the retiree may receive through the HRA. For that reason, employers should provide a retiree with the opportunity to waive HRA coverage for any year in which he or she will be eligible for a premium tax credit. This type of waiver should be made on a prospective basis prior to the beginning of any period for which the retiree would be seeking the premium tax credit.

> **Comment.** Employers will want to determine, as a matter of plan design, whether waived amounts will be forfeited or carried to subsequent years. To simplify administration, some employers are allowing a retiree to defer the entire HRA to age 65 when he or she becomes Medicare eligible.

Retiree-Only HRAs and the Cadillac Tax

Beginning in 2018, a nondeductible 40% excise tax will be imposed on the cost of "applicable employer-sponsored coverage" provided to an employee or retiree that exceeds certain statutory thresholds (see box at right). This excise tax is commonly called the "Cadillac" tax. In IRS Notice 2015-16, the IRS stated that it expects future guidance to provide that HRAs will be subject to the Cadillac tax. (See our February 24, 2015 *FYI Alert.*

What are the Cadillac tax annual cost limits?

For 2018, the annual cost limits for applicable employer sponsored coverage will be $10,200 for self-only coverage and $27,500 for family coverage. For retirees not yet eligible for Medicare who are at least age 55, the annual limits for 2018 will be $11,850 for self-only coverage and $30,950 for family coverage. All of these limits are subject to indexing for subsequent years.

Even if HRAs are subject to the Cadillac tax, those used to provide financial assistance to retirees can help reduce or eliminate the Cadillac tax on retiree coverage. For example, assume that in 2018, the annual cost of self-only coverage under an employer's pre-Medicare retiree group health plan is $15,000. The employer pays $10,000 of the cost and the retiree pays the remaining $5,000. Although the employer's cost is capped at $10,000, the Cadillac tax in 2018 for each retiree with self-only coverage would be 40% of the excess of the full $15,000 cost over the $11,850 annual limit for pre-Medicare retirees. However, if the employer provided the same $10,000 amount through a retiree-only HRA that a retiree could use to purchase individual coverage through a private exchange or public marketplace, only the HRA would be subject to the Cadillac tax. Because the HRA value of $10,000 is less than the $11,850 threshold, no Cadillac tax would be owed.

Note that the above example assumes that the $10,000 annual HRA amount is the value that would be subject to the Cadillac tax. In Notice 2015-16, the IRS proposed three different methods for valuing an HRA for Cadillac tax purposes:

- Amounts made newly available each year
- Adding together all claims and administrative expenses attributable to HRAs for the period
- Actuarial basis

The IRS stated in the Notice that it is considering making only one valuation method to employers. In our May 15, 2015 comment letter to the IRS, Buck recommended that employers be provided the option of using any of these three methods. Once the IRS finalizes the HRA valuation method, employers should review their retiree-only HRA design and evaluate the impact of the IRS guidance. Employers implementing retiree HRAs now should retain flexibility to modify the design in 2018 if needed to avoid the Cadillac tax.

Retiree-Only HRAs and Medicare-Eligible Retirees

For many years, some employers have also used HRAs to provide Medicare-eligible retirees with financial assistance in purchasing Medicare supplemental coverage and to reimburse their Medicare Part B and D premiums. These HRAs must also be established as retiree-only plans to comply with ACA requirements.

Although Medicare-eligible retirees cannot enroll in public marketplace coverage or receive premium tax credits, they may have spouses or children who are not Medicare-eligible. To avoid adversely affecting the eligibility of these spouses or children for the premium tax credit because they have employer-provided MEC through the HRA, employers may want to limit the use of HRA funds to Medicare-eligible retirees and their Medicare-eligible dependents. Alternatively, the employer could permit the retiree to waive coverage under the HRA for individuals who are not Medicare-eligible.

In Closing

Employers that want to provide financial assistance to their pre-Medicare retirees who enroll in marketplace coverage through HRAs need to review their plan design and plan documentation to make certain that their actions don't potentially penalize retirees — and themselves.

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