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Final regs expand use of health reimbursement arrangements

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Authors
Sharon Cohen, JD
Leslye Laderman, JD, LLM

The departments have issued final regulations that expand the flexibility and usefulness of employer-provided health reimbursement arrangements. The regulations set out requirements for an integrated “Individual Coverage HRA” that can be used to pay premiums for individual health insurance and also an “Excepted Benefit HRA” that can be used to cover out-of-pocket medical expenses. While more likely to be used by small and mid-sized employers, the final regulations may also provide large employers an opportunity to subsidize the cost of individual health insurance (in or out of the ACA marketplace) for specific employee groups who previously may not have been offered health coverage.

Background

First recognized by the IRS in 2002, health reimbursement arrangements (HRAs) are employer-sponsored group health plans that can reimburse employees' substantiated, qualified medical expenses (including premiums for health coverage). HRAs are funded solely through employer contributions, generally on a defined contribution basis (i.e., the employer contributes a specific dollar amount each year). HRA reimbursements are excludable from an employee’s taxable income and an employer may deduct its HRA contributions funding as a business expense.

The Affordable Care Act (ACA) substantially curtailed employers’ ability to provide HRAs to active employees. HRAs that reimburse medical expenses are subject to ACA market reforms, (e.g., the prohibition of annual and lifetime limits on essential health benefits and the preventive care mandate) and can only satisfy those reforms if they are "integrated" with other health coverage. In 2013, the Departments of the Treasury, Labor, and Health & Human Services (together, the departments) announced that HRAs could not be integrated with individual coverage or used on a “standalone” basis to purchase health coverage in the individual marketplace. This meant that the only way an

HRA could comply with ACA market reforms was if it was offered to employees enrolled in the employer's comprehensive medical coverage. (See our *FYI* from February 21, 2013.)

In October 2018, the departments issued proposed regulations that set out conditions under which an HRA can satisfy the ACA's market reform mandate through integration with individual coverage. The proposed regulations also created an Excepted Benefit HRA that would not need to be integrated with more comprehensive coverage. (See our December 10, 2018 *FYI*.)

Retiree-only HRAs

Because retiree-only plans (i.e., plans that have fewer than two participants who are current employees on the first day of the plan year) are exempt from the ACA market mandates, they do not have to be integrated with other coverage to satisfy those requirements. See our *FYI* from **August 24, 2015**. The final regulations confirm that these HRAs don't have to meet any of the integration tests and unless they qualify as an excepted benefit (e.g., only provide for reimbursement of dental or vision expenses), they'll constitute minimum essential coverage for purposes of premium tax credit eligibility. These final regulations do not impact employers that offer private health insurance exchanges to their retirees.

Departments finalize new HRA rules

The final regulations generally follow the proposed regulations, but further expand the ability of employers to provide HRAs to their active employees. A news release and FAQs provide additional information. The final regulations generally apply for plan years beginning on or after January 1, 2020.

Individual coverage HRAs

Under the final rules, an employer may provide employees with an HRA that satisfies ACA's market reforms through integration with individual coverage or Medicare if the following conditions are met:

- **Individual insurance/Medicare coverage.** Individuals whose expenses are eligible for HRA reimbursements must be enrolled in individual health insurance or Medicare for each month they are covered by the HRA. The individual health insurance, which may be purchased on or off the ACA marketplace, must cover more than excepted benefits (e.g., dental or vision coverage).
- **Verification of coverage.** The HRA has reasonable procedures to verify that individuals are enrolled in individual health insurance or Medicare for the plan year and to confirm with each request for reimbursement that the individual had coverage for the month in which the expense was incurred. The departments have provided a model attestation that participants can use to attest that they are enrolled in qualifying coverage.
- **Classes of employees.** Employees in the same class are not given a choice between enrolling in an Individual Coverage HRA or the employer's "traditional" group health plan. Employee classes are limited to full-time, part-time, seasonal, salaried, and non-salaried employees; employees in a collective-bargaining unit; those who have not completed an ACA-compliant waiting period for coverage; non-resident aliens with no U.S.-based income; and those whose primary site of

employment is in the same rating area. For classes based on full-time/part-time status, salaried/non-salaried status, or employment in the same rating area (if smaller than a state) that are only offered the Individual Coverage HRA, minimum class size rules apply. For employers with more than 200 employees, the minimum class size is 20.

Minimum class size

The minimum class size rule applies if an employer offers a traditional group health plan to some employees and an Individual Coverage HRA to others based on full-time/part-time status, salaried/non-salaried status, or geographic location (if the location is smaller than a state).

Special rule for new hires. Employers may offer new employees an Individual Coverage HRA while continuing to offer a traditional group health plan to current active employees within the same employee class. Thus, plan sponsors can gradually transition to Individual Coverage HRAs.

> **Buck comment.** A designated class can be employees whose principal place of employment is in the same rating area (used for ACA premium rating requirements in the individual market). This rule will essentially allow employers to vary coverage or benefits based on worksite location.

- **Same terms.** A plan sponsor that provides an Individual Coverage HRA to a class of employees generally must provide it on the same terms (including in the same amount) to all employees in the class. The regulations do not impose a minimum or maximum contribution amount on Individual Coverage HRAs. An employer may vary its contributions based on employee age, however, the maximum dollar amount may not exceed three times the amount made available to the youngest participant in the plan and must be the same level for all participants of the same age. The maximum dollar amount can also be increased if the participant adds dependents. Amounts carried over from prior years (or transferred from another HRA) are disregarded in assessing uniform benefit levels, assuming the same carryover and transfer conditions apply equally within a class. A participant who first becomes covered by an Individual Coverage HRA after the first day of the plan year may receive the full annual amount or the HRA may adopt a reasonable proration method.
- **Opting out.** An employee eligible for the HRA must have the opportunity to opt out and waive future reimbursements from the HRA at least annually. This enables otherwise eligible individuals and covered dependents to potentially receive a premium tax credit (PTC) to offset the cost of premiums for marketplace health insurance.

> **Buck comment.** Individuals and covered dependents are not eligible for a PTC for any month in which the individual is eligible for an HRA that is affordable and provides minimum value. (See our August 24, 2015 *FYI* for a discussion of the PTC.) The rules note that applicable large employers can avoid shared responsibility penalties by offering an affordable Individual Coverage HRA to full-time employees and indicates that more information, including proposed regulations, will be provided. An Individual Coverage HRA is considered affordable for a month if the employee's "required HRA contribution" does not exceed $\frac{1}{12}$ of

the product of his or her household income and the applicable percentage under Section 36B (9.78% for 2020). (See our July 25, 2019 *FYI*.) The "required HRA contribution" is the amount by which the monthly premium for the self-only lowest cost silver marketplace plan in the rating area in which the employee resides exceeds 1⁄12 of the monthly self-only HRA amount provided by the employer.

- **Notice.** To ensure that they understand how enrollment can affect availability of the PTC, individuals eligible to participate in an Individual Coverage HRA must be provided with written notice at least 90 days before the beginning of each plan year, or no later than the date on which the individual first becomes eligible to participate in the HRA. The departments provide model notices to satisfy this requirement.

Marketplace enrollment opportunity

To facilitate access to Individual Coverage HRAs, employees and their dependents have a marketplace special enrollment opportunity when they gain access to an Individual Coverage HRA (or are provided with a qualified small employer HRA, or QSEHRA). See our December 10, 2018 *FYI.*

Status of individual health insurance coverage under ERISA

The final regulations amend the definitions of “employee welfare benefit plan” and “welfare plan” in ERISA to provide a safe harbor exempting individual health insurance funded by an Individual Coverage HRA from ERISA’s requirements. To qualify for the safe harbor:

- Purchase of the insurance must be completely voluntary for employees.
- HRA plan sponsor must not select or endorse any particular insurer or coverage (including a menu of coverage such as a private exchange).
- HRA plan sponsor receives no consideration in connection with the employee's selection or renewal of individual health insurance coverage.
- Reimbursements for non-group health insurance premiums are limited solely to individual health insurance coverage that does not consist solely of excepted benefits.
- Participants are notified annually that individual health insurance coverage is not subject to ERISA.

The exemption applies only to the individual health insurance coverage — the HRA’s status as a group health plan subject to ERISA remains unaffected. These safe harbor provisions, while similar to those that apply

Private exchanges

While employees can use an Individual Coverage HRA to purchase coverage through a private exchange, the exchange must “present all available coverage options in a way that is entirely neutral.” The regulations note that a plan sponsor could maintain (or contract with) a tool or web-based platform that presents information about all coverage options in a state and facilitates enrollment. However, a private exchange will not meet the “no endorsement” requirement if the platform is designed or operated such that it limits the user’s ability to select a coverage option that would otherwise be available to them or that promotes one option over another (for example, with ‘recommended’ or ‘starred’ listings).

to voluntary benefits, are specific to individual health insurance coverage purchased with Individual Coverage HRA funds and would not be applicable to other situations.

In some cases, the dollars in the Individual Coverage HRA may not be enough to cover the full cost of the individual health insurance coverage premium. The final rules clarify that allowing employees to pay the remaining portion of the premium on a pre-tax salary reduction basis through a cafeteria plan will not cause individual health insurance coverage to be subject to ERISA.

Individual coverage HRAs and COBRA

As is the case with HRAs generally, an Individual Coverage HRA is a group health plan subject to COBRA. COBRA requires a group health plan to permit certain individuals who lose employer-sponsored coverage due to a specified "qualifying event" to continue the coverage if they pay the premium. Thus, individuals who have had a qualifying event that triggers a loss of coverage, such as a termination of employment or a reduction of hours, must be offered the opportunity to continue their Individual Coverage HRA coverage through COBRA. However, an employee's or other covered individual's failure to maintain individual health insurance coverage does not create COBRA rights because that is not a qualifying event under COBRA.

The requirement to otherwise be eligible for an Individual Coverage HRA — such as having individual health insurance coverage — remains for the duration of the COBRA coverage. Thus, a qualified beneficiary who fails to maintain individual health insurance coverage would not be able to access Individual Coverage HRA funds for expenses incurred after the termination of individual health insurance coverage.

What about COBRA?

Individual health insurance coverage purchased through an Individual Coverage HRA will be exempt from ERISA's COBRA provisions if it satisfies the law's safe harbor — this is because it would not be considered a group health plan. However, the status of Individual Coverage HRAs under the Code's COBRA provisions is unclear because there is no comparable exemption. That said, it seems unlikely that IRS would take a position contrary to DOL on this issue.

Individual health insurance coverage and cafeteria plans

As noted above, generally, employers may permit employees to use pre-tax (cafeteria plan) salary reduction dollars to pay any portion of their individual insurance premiums that are not covered by the Individual Coverage HRA, as long as the coverage is purchased outside of an ACA marketplace and subject to applicable cafeteria plan guidance. (Special rules apply to small employers and "simple cafeteria plans.") If offered, salary reduction opportunities must be available on the same terms and conditions to all employees within a class.

> **Buck comment.** Allowing employees to pay for individual health insurance coverage through a cafeteria plan should benefit employers who otherwise might not offer health insurance coverage to a specific group (class) of employees. The coverage can be paid for with pre-tax (salary reduction) dollars, which is not subject to employment taxes (normally paid by both the employer and employee) and would be considered a business expense for employers. In terms of the individual health insurance coverage (e.g., the major medical coverage of the employee), employers are also able to avoid health coverage mandates such as ERISA disclosures, claims procedures, COBRA, HIPAA, etc.

Satisfying employer mandate and section 105(h) nondiscrimination rules

Notice 2018-88, issued shortly after the proposed HRA regulations, provides that an Individual Coverage HRA is considered minimum essential coverage for employer mandate purposes. The notice proposed — and requested comments on — safe harbors that employers could use in assessing "affordability" for purposes of the section 4980H(b) assessment. See our *FYI* from December 10, 2018*.* The notice also discussed the conditions under which Individual Coverage HRAs that permit employees in different classes to receive different HRA amounts might satisfy Code section 105(h) nondiscrimination rules. (See our May 3, 2018 *FYI In-Depth* for a discussion of section 105(h) nondiscrimination rules.) These rules generally require employer contributions to be uniform for all HRA participants. A discussion in the preamble of final regulations indicates that the IRS and Treasury will be issuing proposed rules that would incorporate the concepts laid out in Notice 2018-88 and that they received comments.

Excepted Benefit HRAs

Health benefits that qualify as "excepted benefits" are not subject to ACA market reforms. The final regulations generally provide that an Excepted Benefit HRA can reimburse general medical expenses without integration, so long as it satisfies the following conditions:

- **Group health plan coverage available.** The plan sponsor offering the HRA must make (traditional) group health plan coverage available for the plan year to employees eligible for the HRA. However, HRA participants and their dependents would not be required to enroll in the traditional group health plan to be eligible for the Excepted Benefit HRA.
- **Limitation on contributions.** The maximum annual contribution to an Excepted Benefit HRA is $1,800, indexed for inflation after 2020. This does not include carryover amounts, which can be unlimited. If a plan sponsor provides more than one HRA or another account-based group health plan to participants for the same period, the aggregate annual contribution for all such HRAs cannot exceed $1,800.
- **Reimbursable expenses.** The Excepted Benefit HRA can be used to reimburse qualified medical expenses such as copays, coinsurance, deductibles, or otherwise unreimbursed medical expenses as well as premiums for COBRA or other continuation coverage or other HIPAA excepted benefits — individual or group health plan coverage consisting solely of excepted benefits such as limited-scope dental or vision coverage. An Excepted Benefit HRA may not

reimburse premiums for individual health insurance coverage, group health plan coverage, or for Medicare Parts B or D.

- **Uniform availability.** The Excepted Benefit HRA or other account-based group health plan must be available under the same terms to all similarly situated individuals, regardless of any health factor. "Similarly situated" employees (defined under HIPAA) are those in the same employment-based classification, such as full-time, part-time, hourly, salaried, or worksite location. Plan sponsors are prohibited from considering health factors in determining eligibility for and/or the amount of the benefit.

One or the other, not both

The rules prohibit an employer from offering the same group of employees both an Individual Coverage HRA and an Excepted Benefit HRA. An employer can offer an Individual Coverage HRA to a class of employees only if it does not also offer a traditional group health plan to the same employees. In contrast, an employer can offer an Excepted Benefit HRA only if it offers traditional group health plan coverage to the same employees.

ERISA and excepted benefit HRAs

Excepted Benefit HRAs are subject to ERISA and the other mandates connected to ERISA plans. The "exception" for the Excepted Benefit HRA is that it is exempt from the ACA's market mandates and HIPAA's portability and nondiscrimination rules. Because it is subject to ERISA, a plan sponsor may be required to file a Form 5500 and provide participants with a summary plan description. In addition, HRA reimbursements must be handled in accordance with ERISA's claims and appeal procedures.

Satisfying nondiscrimination rules

Unlike the rules for Individual Coverage HRAs, there is no specific exception from the section 105(h) nondiscrimination rules for an Excepted Benefit HRA. This means that, for example, an Excepted Benefit HRA that provides a larger benefit to more senior, salaried employees could be potentially discriminatory under section 105(h).

Why large employers may consider Individual Coverage and Excepted Benefit HRAs

Although smaller employers appear to be the intended beneficiaries of the new guidance, large employers may find reasons to offer Individual Coverage HRAs to certain employees.

- **Tax-favored treatment.** Individual Coverage HRAs offer employers (of all sizes) a tax-favored, defined contribution approach to providing groups of employees subsidies to purchase individual health insurance coverage. The amounts contributed to the HRA would be free from employment and income tax as well as considered a business expense for the employer. In addition, for individual health insurance purchased outside the ACA marketplace, the amount of the premium not covered by the HRA can be funded with pre-tax dollars through a cafeteria plan. (A cafeteria plan can be used in limited circumstances to purchase ACA marketplace coverage (i.e., a "simple cafeteria plan"). These amounts would also be excluded from employment and income tax and deemed a business expense.

- **Flexibility for providing benefits to specific groups.** Employers can offer specific subsets of employees (like part-timers) an Individual Coverage HRA as well as vary contributions based on age and family size. This approach provides employers with an affordable opportunity to subsidize some health benefits for groups of employees that the employer wants to attract and retain but otherwise would prefer not to fully cover under the group health plan. It's possible that such an approach would work well in the retail or food-service industries.
- **Shared responsibility coverage requirement.** To meet the ACA's employer shared responsibility mandate to offer health coverage to at least 95% of full-time employees, some employers provide only preventive coverage or a "minimum essential coverage" (MEC) plan to those who otherwise would not be eligible for coverage under the employer's traditional group health plan. The Individual Coverage HRA guidance provides another avenue for employers to meet this requirement and subsidize more comprehensive health coverage sold in the individual market.
- **Expand coverage offerings.** The Excepted Benefit HRA can reimburse qualified medical expenses such as copays, coinsurance, deductibles, or otherwise unreimbursed medical expenses, but also COBRA or other continuation coverage premiums or other HIPAA excepted benefits, like limited-scope dental or vision coverage or voluntary benefits.

Which employers are subject to the nondiscrimination rules?

If you build it, will they come? To a large degree, the success of the Individual Coverage HRA depends on a robust individual marketplace. To what extent this new HRA will stimulate the individual market and increase competition and offerings is unknown.

In closing

At first glance, it appears that the Individual Coverage HRA and the Excepted Benefit HRA will have the most significant impact on smaller and mid-size employers. These HRAs may also provide the means for large employers to offer tax-favored subsidies to specific groups of employees who otherwise would not be offered health coverage. It's unclear if these HRAs will help invigorate the individual health insurance plan market and stimulate competition so that more individual health insurance options are available.

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