Provided by Touchstone Consulting Group

Qualified Small Employer HRAs

Effective for plan years beginning on or after Jan. 1, 2017, small employers that do not maintain group health plans may establish stand-alone health reimbursement arrangements (HRAs). This new type of HRA is called a “qualified small employer HRA” (or QSEHRA).

Due to the Affordable Care Act (ACA), most stand-alone HRAs have been prohibited since 2014. The QSEHRA is a special exception for small employers that are not subject to the ACA’s employer shared responsibility rules. Instead of offering a group health plan, small businesses may use a QSEHRA to reimburse employees’ out-of-pocket medical expenses, including their premiums for individual health insurance coverage, on a tax-free basis.

Small employers that do not sponsor group health plans may want to consider implementing a QSEHRA to help their employees pay for out-of-pocket medical expenses. Because there are specific design requirements for these HRAs, including a maximum benefit limit and an employee notice, small businesses should work with their advisors to make sure their QSEHRAs are compliant.

LINKS AND RESOURCES

- The 21st Century Cures Act, which created QSEHRAs, effective for plan years beginning on or after Jan. 1, 2017
- IRS Notice 2017-20

HIGHLIGHTS

QSEHRAS

- QSEHRAs are a type of stand-alone HRA that can reimburse employees for their individual health insurance premiums without violating the ACA.
- Only small employers that are not subject to the ACA’s employer shared responsibility rules can adopt QSEHRAs.

BASIC REQUIREMENTS

- There is a maximum benefit limit for QSEHRAs each year. The current limit is $4,950 (or $10,000 for QSEHRAs that also cover family members).
- A QSEHRA must be provided on the same terms to all eligible employees, with some limited exceptions.
- QSEHRAs can reimburse medical care expenses, including health insurance premiums.

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BACKGROUND

HRAs are employer-funded arrangements that reimburse employees for certain medical care expenses on a tax-free basis, up to a maximum dollar amount for a coverage period. The ACA includes market reforms that limit the availability of HRAs, beginning in 2014. Under these reforms, most stand-alone HRAs have been prohibited. A stand-alone HRA is an HRA that is not offered in conjunction with a group health plan.

On Dec. 13, 2016, the **21st Century Cures Act** (Act) was signed into law. The Act creates a new type of HRA—the QSEHRA. The Act provides that a QSEHRA is not a group health plan, which means QSEHRAs are not subject to the ACA's market reforms that have limited the availability of stand-alone HRAs.

Beginning in 2017, small business owners have a new benefit option available to them—they can contribute to a stand-alone HRA instead of offering a group health plan.

Effective Jan. 1, 2017, an eligible employer may offer a stand-alone HRA without incurring penalties under the ACA if the HRA meets the requirements for a **QSEHRA**. This type of HRA can be used to help employees pay for their own health insurance policies and reimburse other out-of-pocket medical expenses.

ELIGIBLE EMPLOYERS

To be eligible to offer a QSEHRA, an employer must meet the following two requirements:

- ✓ The employer is not an applicable large employer (ALE) that is subject to the ACA's employer shared responsibility rules; and
- ✓ The employer does not maintain a group health plan for any of its employees.

ALEs are employers that employ, on average, at least 50 full-time employees, including full-time equivalents, during the preceding calendar year. ALE status is determined on a controlled group basis.

ALEs that sponsor a group health plan for some or all of their employees cannot offer a QSEHRA. Thus, it is **not** permissible for an ALE to offer a group health plan to certain groups of employees (for example, salaried or management employees) and a QSEHRA to other groups.

DESIGN REQUIREMENTS

Like all HRAs, a QSEHRA must be **funded solely by the employer**. Employees cannot make their own contributions to an HRA, either directly or indirectly through salary reduction contributions. In addition, the following requirements apply to QSEHRAs:

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Maximum Benefit	• The **maximum benefit** available under the QSEHRA for any year cannot exceed **$4,950** (or **$10,000** for QSEHRAs that also reimburse medical expenses of the employee's family members). • These dollar amounts are subject to adjustment for inflation for years beginning after 2016. • The maximum dollar limits must be prorated for individuals who are not covered by the QSEHRA for the entire year.
Eligibility and Benefit Rules	The QSEHRA must be provided on the **same terms to all eligible employees** except: • The maximum benefit may vary based on age and family-size variations in the price of an individual policy in the relevant individual health insurance market; • The QSEHRA may exclude certain categories of employees, including collectively bargained employees, employees who are part time or seasonal, employees who have not completed 90 days of service, employees who are younger than age 25 and nonresident aliens without earned income from sources within the United States; and • A QSEHRA may be designed to include a waiting period for newly eligible employees that does not exceed 90 days.
Reimbursements	• QSEHRA payments or reimbursements must be limited to Code Section 213(d) **medical care expenses** incurred by the employee or the employee's eligible dependents, **after the employee provides proof of coverage**. • This would include, for example, premiums for health insurance coverage and other out-of-pocket medical expenses. • Out-of-pocket medical expenses that have been reimbursed from another source are not eligible for reimbursement. Also, a QSEHRA cannot reimburse health insurance premiums that have been paid on a pre-tax basis (for example, premiums paid on a pre-tax basis for coverage under a health plan maintained by a spouse's employer). • QSEHRA reimbursements are generally tax-free, unless the employee does not have minimum essential coverage (MEC) for the month. MEC includes, for example, health coverage under a government-sponsored program (such as Medicare), an employer-sponsored health plan or health insurance coverage purchased in the individual market.

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EMPLOYEE NOTICE

An employer funding a QSEHRA for any year must provide a written notice to each eligible employee. This notice must be provided **no later than 90 days before the beginning of the year**. For employees who become eligible to participate in the QSEHRA during the year, the notice must be provided by the date on which the employee becomes eligible to participate.

If an employer fails to provide this notice for a reason other than reasonable cause, the employer may be subject to a penalty of $50 per employee for each failure, up to a maximum annual penalty of $2,500 for all notice failures during the year.

The notice must include the following information:

- ✓ The employee's maximum benefit under the QSEHRA for the year;
- ✓ A statement that, if the employee is applying for advance payment of the premium assistance tax credit, the employee should provide the Exchange with information about the QSEHRA's maximum benefit; and
- ✓ A statement that, if the employee is not covered under MEC for any month, the employee may be subject to a penalty under the ACA's individual mandate and reimbursements under the QSEHRA may be includible in gross income.

As transition relief, the Cures Act gave small employers until March 13, 2017, to provide the initial QSEHRA notice. However, on Feb. 27, 2017, the Internal Revenue Service (IRS) issued Notice 2017-20 to **delay the initial QSEHRA notice deadline until further guidance is issued**. According to the IRS, the new deadline for providing the initial QSEHRA notice will be no earlier than 90 days following the issuance of this guidance. In the meantime, employers that provide the QSEHRA notice to their eligible employees may rely upon a reasonable good faith interpretation of the Cures Act to determine the contents of the notice.

> A sample QSEHRA notice is provided on the last page of this document. The sample requires customization.

OTHER COMPLIANCE ISSUES

ERISA	An HRA is an employee welfare benefit plan under the Employee Retirement Income Security Act of 1974 (ERISA). Unless an employer is exempt from ERISA because it qualifies as a church or governmental employer, its HRA must comply with ERISA's standards. This means that the HRA must have a plan document and summary plan description (SPD) and is subject to the Form 5500 annual

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	filing requirement (unless an exception applies). ERISA's general compliance requirements for employee benefit plans apply to QSEHRAs, although the special rules for group health plans may be inapplicable. More guidance from federal agencies on this topic would be helpful.
COBRA	HRAs are group health plans that are subject to COBRA, unless the employer sponsoring the plan is a small employer (with fewer than 20 employees) or a church. **QSEHRAs, however, are not subject to COBRA.**
HIPAA	HRAs are group health plans that are subject to the Health Insurance Portability and Accountability Act's (HIPAA) Privacy and Security Rules, unless they qualify for the exemption for small plans (with fewer than 50 participants) that are self-insured and self-administered. These same rules likely apply to QSEHRAs, although guidance from federal agencies on this issue would be helpful.
Nondiscrimination	QSEHRAs must be provided on the same terms to all eligible employees, subject to the limited exceptions described above.
W-2 Reporting	Small employers that sponsor QSEHRAs must report each employee's permitted benefit on his or her Form W-2 for the year.
Exchange Subsidies	The value of QSEHRA coverage is taken into account when determining an employee's eligibility for a premium tax credit under an ACA Exchange as follows: • If an employee's QSEHRA benefit provides "affordable" coverage, he or she will not be eligible for a premium tax credit. QSEHRA coverage is considered affordable for a month if (1) the excess of the self-only premium under the second lowest-cost silver plan offered in the relevant individual health insurance market over 1/12 of the employee's permitted benefit under the QSEHRA is not greater than (2) 1/12 of 9.5 percent (as indexed) of the employee's household income. • If a QSEHRA does not provide affordable coverage, an employee may still be eligible for a premium tax credit, but the amount of the monthly credit is reduced by 1/12 of the employee's permitted benefit under the QSEHRA.

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SAMPLE QSEHRA NOTICE

Important Information about Your QSEHRA Coverage

Effective [insert date], [Your organization] (Company) sponsors a new type of medical reimbursement plan—called a qualified small employer health reimbursement arrangement (or QSEHRA)—for eligible employees. A recent change to the federal tax laws makes it possible for small employers like the Company to sponsor this type of employee benefit. The QSEHRA is an important benefit because it can be used to pay (or reimburse you) for [include a brief description of the expenses that are covered under the QSEHRA, such as premiums for individual health insurance policies and/or other out-of-pocket medical expenses].

Please read below for key information regarding your QSEHRA coverage.

- ***Maximum Annual Benefit:*** Your maximum benefit under the QSEHRA for this year is **[insert amount]**.
- ***Exchange Coverage:*** If you purchase health insurance through an Affordable Care Act (ACA) Exchange and you apply for advance payment of the premium tax credit, **you will need to provide the Exchange with information about your maximum QSEHRA benefit**.

  There are special rules for coordinating your QSEHRA coverage with your eligibility for a premium tax credit. If your QSEHRA benefit makes your health insurance coverage "affordable" under a federal definition, you will not be eligible for a premium tax credit. If your coverage is not affordable, you may still be eligible for a premium tax credit, but the amount of the credit will be reduced by your QSEHRA benefit.
- ***Tax Rules:*** In general, payments or reimbursements from the QSEHRA are not included in your income for federal tax purposes. **However, if you do not have health insurance coverage that qualifies as "minimum essential coverage" for any month, you may be subject to a penalty under the ACA for that month and any reimbursements you receive from the QSEHRA may be taxable to you.**

For more information on your QSEHRA coverage, contact [insert contact information].

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