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Qualified Small Employer Health Reimbursement Arrangements Available for Small Employers

ELIZABETH LOH
AND MARY POWELL

On December 13, 2016, the 21st Century Cures Act ("Act") was enacted. The Act contains a special holiday gift for small employers. The Act allows a small employer to offer "Qualified Small Employer Health Reimbursement Arrangements" ("QSEHRA") that may be used by eligible employees for the reimbursement of medical expenses, including coverage on the individual market.

Background

Prior Internal Revenue Service ("IRS") guidance clarified that Health Reimbursement Arrangements ("HRAs") are considered "group health plans" that are subject to the group market reform provisions of the Affordable Care Act (the "ACA"), including the prohibition on annual dollar limits, and the requirement to provide certain preventive services without cost-sharing. This prior guidance generally meant that employers could not sponsor stand-alone HRAs, because such stand-alone HRAs would not satisfy the various ACA group market reform requirements. This IRS guidance also clarified that an employer could not use an HRA to reimburse employees for premiums paid for individual market coverage.

To address employer concerns, the Act allows small employers to offer arrangements (QSEHRAs) that are similar to HRAs, which may be used to pay or reimburse qualifying medical expenses, including coverage on the individual market. These arrangements and their associated compliance obligations are described further below.

Small employers may offer a QSEHRA

A small employer may sponsor a QSEHRA. A small employer is an employer that does not qualify as an Applicable Large Employer under the Internal Revenue Code Section 4980H rules. In other words, an eligible employer is generally one that employs fewer than 50 full-time employees (including full-time equivalent employees) in the previous year. Note: The determination of whether an employer is an Applicable Large Employer is made on a controlled group basis.

Cannot offer any group health plan

The small employer may not offer a group health plan to any of its employees (*e.g.*, medical, dental, vision plans, etc.). Again, the controlled group rules apply in determining whether a group health plan is offered to any employee.

Which employees are eligible to participate in a QSEHRA?

If an eligible employer sponsors a QSEHRA, it must offer such arrangement to all of its "eligible employees." The Act defines "eligible employees" fairly broadly to include "any employee of an eligible employer." However, an eligible employer is allowed to exclude the following categories of employees from participation in the QSEHRA:

- Employees who have not completed 90 days of service;
- Employees under the age of 25;
- Part-time and seasonal employees;
- Union employees unless the relevant collective bargaining agreement provides for eligibility; and
- Employees who are non-resident aliens with no U.S. source income.

Proof of health coverage

It appears from the legislation that in order for the employee to be eligible for the QSEHRA, the employee must show proof of coverage. However, it is unclear what this requirement means. We anticipate that the IRS will issue further guidance on this issue.

How does a QSEHRA work?

- **Employer funded.** A QSEHRA is an arrangement that is funded solely by eligible employer contributions. Employees may not make contributions to a QSEHRA.
- **Eligible reimbursements.** An eligible employee who is covered by a QSEHRA may receive reimbursement for his or her medical expenses (as defined in Internal Revenue Code section 213(d)), as well as the medical expenses of his or her eligible family members. The eligible employee must provide the employer with proof of his or her medical expenses prior to receiving reimbursement under the QSEHRA. It's worth noting that these medical expenses include (but are not limited to) insurance premiums for individual insurance coverage. However, it is unlikely that an eligible employee may receive reimbursement under a QSEHRA (on a tax advantaged basis) for the insurance premiums paid for by a spouse on a pre-tax basis through the spouse's employer's group health plan — since this would result in doubling the employee's tax benefit (*i.e.*, "double dipping").
- **QSEHRA must be offered on same terms to all eligible employees.** An eligible employer must offer the QSEHRA on the same terms to all of its eligible employees. However, an arrangement shall not fail to be treated as provided on the same terms to each eligible employee merely because the employee's permitted benefit under such arrangement varies in accordance with the variation in the price of an insurance policy in the relevant

individual health insurance market based on: (1) the age of the eligible employee and family members covered or (2) the number of family members covered under the arrangement. This variation is determined by reference to the same insurance policy with respect to all eligible employees.

- **Reimbursement limits.** The maximum amount of reimbursement that an eligible employee may receive for any year is $4,950 (employee only coverage), or $10,000 (for family coverage). If an individual is not covered by a QSEHRA for the entire year, the amount of his QSEHRA is pro-rated. For example, if an eligible employee and his family members are covered by a QSEHRA for six months out of the year, they would be eligible to receive $5,000 in QSEHRA reimbursements (instead of the full $10,000 available for those eligible employees who have QSEHRA coverage for all 12 months of the year).
- **Tax-advantaged vehicle.** Generally, an eligible employee is not taxed on the medical expense reimbursements he receives through a QSEHRA. However, if the eligible employee does not have "minimum essential coverage," then any reimbursements he receives through the QSEHRA are considered taxable and must be included in the employee's gross income. For example, if an eligible employee is covered by an individual medical insurance policy (*i.e.*, "minimum essential coverage") and receives reimbursements through a QSEHRA for his individual insurance premiums, these reimbursement amounts are not taxable to the employee. In contrast, if an eligible employee does not have "minimum essential coverage" for certain months of the year (*e.g.*, is not covered by an individual medical insurance policy, Health Insurance Marketplace coverage, etc.) and receives QSEHRA reimbursements — these reimbursements are taxable to the employee.
- **QSEHRA reimbursement amounts impact potential Health Insurance Marketplace subsidies.** Depending on the amount of reimbursement that an eligible employee may receive from a QSEHRA, these reimbursement amounts may reduce (or completely eliminate) the amount of subsidy the eligible employee (and spouse and dependent) may receive through the Health Insurance Marketplace. In particular, if the QSEHRA offers "affordable" coverage, an employee will not be eligible for the Health Insurance Marketplace subsidy.

Employer requirements when sponsoring a QSEHRA

An eligible employer who sponsors a QSEHRA will have certain compliance obligations, including the following:

- **Notice requirements.** An eligible employer must provide eligible employees with a notice describing (i) the amount available for reimbursement under the QSEHRA for the year; (ii) an explanation that if the eligible employee applies for a Health Insurance Exchange premium assistance tax credit (*i.e.*, subsidy), such employee must inform the Health Insurance Exchange of the amount he or she is eligible to receive through the QSEHRA; and (iii) a statement that if the eligible employee is not covered under "minimum essential coverage" for any month, the employee may be subject to individual mandate penalties, and any reimbursements under the QSEHRA will be includible in the employee's gross income.

The eligible employer must provide the eligible employee with this notice no later than 90 days before the beginning of the year (or the date that the eligible employee is first eligible to participate in the QSEHRA). If an eligible employer does not provide the required notice, it may be subject to penalties that range from $50 per employee per failure, up to $2,500 for the calendar year.

- **Obtaining substantiation from eligible employees.** The eligible employer must collect substantiation (*e.g.*, receipts) from an eligible employee of his or her medical expenses prior to reimbursing such eligible employee under the QSEHRA.
- **Form W-2 reporting.** The eligible employer must report the amount available for reimbursement under the QSEHRA on the eligible employee's Form W-2.
- **HIPAA privacy and security.** A QSEHRA is considered a HIPAA "covered entity" that is subject to the HIPAA privacy and security rules. However to the extent that the eligible employer's QSEHRA has under 50 participants and is self-administered (*i.e.*, a third party administrator is not used to administer the QSEHRA), the eligible employer will not be subject to the HIPAA privacy and security rules with regards to the QSEHRA.
- **ERISA obligations.** Although a QSEHRA is not considered an ERISA "group health plan," it is still an employee benefit arrangement that is subject to ERISA and its accompanying compliance obligations (*e.g.*, plan document requirements, etc.)

No federal COBRA obligations

In welcome news, the QSEHRA is not considered a "group health plan" for purposes of the COBRA rules. Therefore, the eligible employer does not have to offer eligible employees (or their family members) the opportunity to elect federal COBRA continuation coverage for the QSEHRA.

Conclusion

These QSEHRA rules generally apply to plan years beginning after December 31, 2016. If you have any questions regarding this article, please contact the authors of this article, or any of the attorneys at the firm.

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EMAIL ELIZABETH LOH