

Market Reform and HRAs

Cross References

- IRC §105(b), *Amounts expended for medical care*
- H.R. 34

HRA. A health reimbursement arrangement (HRA) is an employer sponsored plan that reimburses the cost of qualified medical expenses incurred by the employee. Similar to an accountable plan, the employee submits receipts to the employer for proof of medical costs, and the employer reimburses the employee for such costs up to a maximum dollar amount per year. If the expense qualifies under IRC section 213 as a qualified medical expense [expenses that otherwise qualify as medical expenses on Schedule A (Form 1040)], the reimbursement is excluded from the employee's compensation under IRC section 105(b). HRAs can be used to help the employee pay for deductibles and co-pays, as well as the cost of medical insurance premiums.

Example #1

Ben has two employees and provides each employee with an HRA in which he reimburses up to \$4,000 per year of their medical costs. Employees can use the \$4,000 to purchase their own health insurance policy, and/or use it to cover out-of-pocket expenses such as deductibles and co-pays that are not covered by health insurance. The reimbursements are deductible by Ben as an employee fringe benefit, and tax free to Ben's employees.

Market reforms. Under the market reform rules of the Affordable Care Act (ACA), a group health plan with two or more participants cannot establish lifetime or annual limits on the dollar amount of benefits for any individual participant in the plan. This rule basically was designed to prevent insurance companies from limiting the amount of medical expenses in which they would cover. However, the rules also apply to employer provided group health plans. The IRS issued regulations that stated any HRA in which an employer reimburses an employee's medical costs, including the employee's cost of health insurance premiums, would violate the market reform rules because the annual benefit under the plan is limited.

Example #2

Assume the same facts as Example #1. Under the market reform rules, Ben's HRA is an employer group health plan because it covers more than one employee. As an employer group health plan, it is in violation of the prohibition on placing an annual limit on health benefits because the HRA reimburses no more than \$4,000 per employee per year.

The penalty for violating the market reform rules is \$100 per day per applicable employee, which is \$36,500 per year per employee. (IRC §4980D)

In other guidance, the IRS stated that if the HRA is integrated with other coverage as part of a group health plan and the other coverage alone would comply with the annual dollar limit prohibition, the fact that benefits under the HRA by itself are limited does not fail to comply with the annual dollar limit prohibition because the combined benefit satisfies the requirements. Thus, HRAs could still be offered by employers provided the employer purchases health insurance for the employee in addition to the HRA benefits.

Author's Comment

Tax industry experts complained that the IRS interpretation of the market reform rules under ACA contradicted the purpose of the health care reform law. Some small employers cannot afford to purchase health insurance for their employees, but may wish to contribute something towards their employee's cost of health insurance. The IRS regulations were forcing small employers to drop their HRA plans entirely causing their employees to incur 100% of the cost of their health insurance coverage. As a result, legislation was introduced to exclude HRAs from the definition of employer group plans subject to the market reform rules.

H.R. 34: The 21st Century Cures Act. Congress has passed H.R. 34 and the President is expected to sign the bill into law shortly. Under section 18001 of H.R. 34, the term "group health plan" does not include any qualified small employer health reimbursement arrangement (Qualified HRA). A Qualified HRA is an arrangement which:

- Is provided on the same terms to all eligible employees of the employer,
- Is funded solely by the employer, meaning no salary reduction contributions are made by the employee to help fund the arrangement,
- Provides the employee with reimbursements for medical expenses incurred by the employee or the employee's family [medical expenses otherwise deductible under IRC section 213(d)] after the employee provides proof of coverage or payment of or reimbursement of such expenses, and
- The amount of payments and reimbursements for any year do not exceed \$4,950 for each individual employee or \$10,000 per employee if the arrangement includes the employee's family members.

A Qualified HRA does not fail to be treated as provided on the same terms to each eligible employee merely because the employee's permitted benefit varies in accordance with the variation in the price of an insurance policy in the relevant individual health insurance market based on age or number of family members. This permitted variation is determined by reference to the same insurance policy with respect to all eligible employees.

If an employee is not covered by the Qualified HRA for the entire year (such as a new employee), the annual dollar limits are pro-rated on a monthly basis. The \$4,950 and \$10,000 annual limitations are also adjusted for inflation for years beginning after 2016.

An eligible employee means any employee of an eligible employer, except that the employer may exclude employees who:

- Have not completed at least 90 days of service,
- Are under age 25,
- Are part-time or seasonal employees,
- Are certain union employees covered under a union agreement, or
- Are certain nonresident aliens.

An eligible employer is:

- One who is not an applicable large employer defined in IRC section 4980H (employers with at least 50 full-time equivalent employees who are required to offer affordable minimum essential coverage for their full-time employees), and
- One who does not offer a group health plan to any of its employees.

Author's Comment

An employer who offers employer group health coverage plus an HRA to employees would not be offering a Qualified HRA. Presumably the HRA would still be an HRA, just not a Qualified HRA. The IRS has already ruled that HRAs integrated with other group health coverage do not violate the market reform rules.

In addition to the above rules, payments or reimbursements from a Qualified HRA of an individual for medical care are not treated as paid or reimbursed under employer-provided coverage for medical expenses under an accident or health plan if for the month in which such medical care is provided the individual does not have minimum essential coverage, within the meanings of IRC section 5000A(f).

Author's Comment

In other words, the employee must provide proof of health insurance coverage before any Qualified HRA benefits can be excluded from the employee's income under IRC section 105(b).

The law also has conforming provisions with the Premium Tax Credit (PTC), which basically denies a double benefit if the employee receives an HRA reimbursement and also qualifies for the PTC.

The new law applies to plan years beginning after December 31, 2016. However, transition relief provides that the \$100 per day penalty for small employers that have less than 50 full-time equivalent employees will not be subject to the penalty for plan years beginning on or before December 31, 2016.