

## EMPLOYEE BENEFITS

### SMALL EMPLOYER STANDALONE HRA ALLOWED BY NEW LAW

by Cynthia A. Moore

Effective January 1, 2017, small employers with fewer than 50 full-time employees will be allowed to offer employees a standalone health reimbursement account ("HRA") without being subject to an excise tax under a law passed by Congress as part of the 21st Century Cures Act.

#### Background

Under current law, the IRS has taken the position that an HRA that is not "integrated" with another ACA-compliant health plan violates the ACA's market reforms. This would subject the employer to an excise tax under Section 4980D of the Internal Revenue Code ("Code") of \$100 per day for each affected participant. Many small employers had traditionally reimbursed employees for individual health insurance premiums or other non-covered medical expenses, so the IRS position was detrimental to those employees.

#### Qualified Small Employer Health Reimbursement Arrangement

Under the new law, a small employer that does not offer a group health plan to its employees may offer employees an HRA that would not be subject to the excise tax if it is a "qualified small employer health reimbursement arrangement" ("Qualified HRA").

A Qualified HRA must meet the following conditions:

1. It is provided on the same terms to all eligible employees. Notwithstanding this general rule, the benefit may vary based on the cost of health insurance tied to the employee's age and/ or number of family members covered. Thus, an employer could provide a greater benefit to an employee who is older or covers multiple family members.
2. It is funded solely by the employer. No employee salary reduction contributions are allowed.
3. The Qualified HRA pays or reimburses an employee for medical expenses under Code Section 213(d) following proof of coverage. Eligible expenses include premiums for an individual health insurance policy.
4. Reimbursements under the Qualified HRA do not exceed \$4,950 for the employee only or \$10,000 for family coverage. These amounts are pro-rated for an employee who is covered for a partial year and will be indexed in future years.
5. All employees must be offered coverage under the Qualified HRA other than:
  - (a) Employees with less than 90 days of service;

- (b) Employees younger than age 25;
- (c) Part-time and seasonal employees;
- (d) Union employees; and
- (e) Non-resident aliens.

Thus, the Qualified HRA is not intended to solely benefit owners, executives or highly compensated employees of the employer.

#### Notice Requirement

An employer offering a Qualified HRA must provide each eligible employee a written notice at least 90 days before the beginning of the year including:

1. The amount of the permitted benefit under the Qualified HRA for the year;
2. A statement that if the employee is applying for advance payment of the premium tax credit for health insurance on the Marketplace, the employee must inform the Marketplace of the amount of the permitted benefit under the Qualified HRA.
3. A statement that if the employee is not covered under minimum essential coverage for any month, the employee may be subject to a tax under Code Section 5000A and reimbursements under the Qualified HRA may be taxable income.

Under a transition rule, for 2017, the notice must be provided within 90 days after the date of enactment of the new law.

An employer is subject to a penalty of \$50 per employee for a failure to provide the notice, up to \$2,500 per year.

#### Income Inclusion

An employee may be taxed on reimbursements from the Qualified HRA if he or she does not have minimum essential coverage. In other words, an employee cannot enjoy a tax benefit from the Qualified HRA if the employee does not maintain minimum essential coverage. It is unclear how or if an employer is to verify whether an employee has minimum essential coverage.

#### Premium Tax Credit

If an employee enrolls in a qualified health plan on the Marketplace, his or her premium tax credit will be reduced by the benefit available under the Qualified HRA.

#### W-2 Reporting

The employer is required to report the benefit available under the Qualified HRA on each employee's Form W-2 beginning in calendar year 2017.

### Penalty Relief

In another favorable development under the new law, a small employer that has been reimbursing individual health insurance premiums or other medical costs from a standalone HRA before January 1, 2017 will not be subject to the \$100 per day penalty under Code Section 4980D.

### Exempt From COBRA

A Qualified HRA will not be treated as a group health plan for purposes of COBRA continuation coverage. Thus, upon a termination of employment or occurrence of another qualifying event, the employer does not need to provide a COBRA notice or continued coverage under the Qualified HRA.

The new law allowing Qualified HRAs provides a way for small employers to provide pre-tax assistance to employees to purchase an individual health insurance policy, and is welcome relief from the onerous tax penalties that would have otherwise applied.

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