



Qualified Small Employer Health Reimbursement Arrangements Permitted, Beginning in 2017

Conner & Winters, LLP

Danny Miller
dmiller@cwlaw.com
(202) 887-4783

Allison Gardner
agardner@cwlaw.com
(918) 586-8506

Jewelie Grape
jgrape@cwlaw.com
(651) 633-1717

www.cwlaw.com

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On December 13, 2016, President Obama signed the 21st Century Cures Act (“Act”) into law. The Act allows qualified small employers to offer a new type of health reimbursement arrangement (“HRA”) to help employees pay for their medical expenses, effective January 1, 2017.¹ The new arrangement is called a “qualified small employer health reimbursement arrangement” (or a “QSEHRA”). QSEHRAs will not be considered “group health plans” under the Patient Protection and Affordable Care Act (“Affordable Care Act”), so market reform requirements will not apply to QSEHRAs.

Eligible qualified small employers will be allowed to pay or reimburse employees’ eligible medical care expenses through a QSEHRA on a pre-tax basis. Employers are eligible to offer a QSEHRA if they (i) are not applicable large employers as defined under the Affordable Care Act,² and (ii) do not offer a group health plan to any of their employees.

A QSEHRA must meet the following requirements:

- All employees of the employer must be covered by the QSEHRA, unless they have not completed 90 days of employment, are under the age of 25, are part-time or seasonal employees, are covered under a collective bargaining agreement that does not provide for coverage under the QSEHRA, or are nonresident aliens with no U.S. source income.
- The QSEHRA must be provided on the same terms to all eligible employees. An employee’s permitted benefit under the QSEHRA is allowed to vary in accordance with the variation in the price of an insurance policy in the relevant individual health insurance market, based on the age of the eligible employee and covered family members, or the number of family members of the eligible employee covered.
- The QSEHRA must be funded solely by the eligible employer; no employee salary reduction contributions are allowed.

- The QSEHRA must provide for the payment of, or reimbursement of, eligible medical care expenses (as described in section 213(d) of the Internal Revenue Code) incurred by the eligible employee or the eligible employee's family members (including premiums for individual health coverage), but only after the employee provides proof of health coverage or expense. The Act does not describe the types of proof that are considered acceptable.³
- The employer must ensure that, in 2017, annual payments or reimbursements from the QSEHRA to an eligible employee do not exceed \$4,950 (\$10,000 if family members are covered under the QSEHRA).⁴ If an individual is not covered under a QSEHRA for the entire year, this dollar limitation is prorated for the number of months the individual is covered by the QSEHRA.

Notice Requirement. An eligible employer funding a QSEHRA must provide an annual written notice to eligible employees not later than 90 days before the beginning of the year (or, in the case of an employee who is not eligible to participate in the QSEHRA as of the beginning of a year, the date on which the eligible employee is first eligible to participate in the QSEHRA). The Act also includes transition relief for 2017 under which an employer will not be treated as failing to provide a notice as long as the notice is provided no later than 90 days after enactment of the Act (that is, by March 16, 2017). The notice must contain the following information:

- The amount of the eligible employee's permitted benefit⁵ under the QSEHRA for the year.
- A statement that the eligible employee should provide information regarding the amount of the employee's permitted benefit to any health insurance exchange to which the employee applies for advance payment of a premium assistance tax credit.
- A statement that, if the employee is not covered under minimum essential coverage for any month, the employee may be subject to tax under the individual mandate requirement of the Affordable Care Act, and that reimbursements from the QSEHRA may then be includible in gross income.

If the employer fails to provide the required written notice (unless it can be shown the failure is due to reasonable cause and not willful neglect), the employer is liable for a penalty equal to \$50 per employee per incident of failure, up to a total amount of \$2,500 per calendar year.

HIPAA. Although unclear, a QSEHRA probably will be considered a covered entity (a health plan) and therefore be subject to HIPAA privacy and security rules. However, if less than 50 employees participate in the QSEHRA, and the QSEHRA is self-administered, then the QSEHRA is not subject to HIPAA rules.

COBRA. QSEHRAs are not subject to federal COBRA continuation coverage requirements.⁶

Coordination with premium tax credit/marketplace subsidy. Amounts paid or reimbursed under the QSEHRA for any coverage month will reduce the amount of premium tax credit/marketplace subsidy available to an eligible employee by 1/12 of the employee's permitted benefit available to be reimbursed under the QSEHRA for that month. If the QSEHRA provides affordable coverage,⁷ employees will not be eligible for a marketplace subsidy.

Taxability of QSEHRA payments. As discussed above, an employee must have minimum essential coverage⁸ for the month in which the medical care is provided in order for the payment or

reimbursement from a QSEHRA for medical care expenses described in section 213(d) of the Code to be tax-free to the employee.

W-2 Reporting. The employer must report the total amount of permitted benefit for the year under the QSEHRA on employees' Forms W-2.

Transitional Relief Extended. The Act also extended transitional relief provided under Treasury Notice 2015-17 to employer payment plans for plan years beginning on or before December 31, 2016. This means that the excise tax under Code section 4980D will not be imposed for any failure to satisfy the market reforms by employer payment plans of small employers (*i.e.*, those that are not applicable large employers) that pay, or reimburse employees for, individual health policy premiums or Medicare Part B or Part D premiums.⁹ Such employers are not required to file IRS Form 8928 solely as a result of having such an arrangement for plan years beginning on or before December 31, 2016. Please note that this relief does not extend to stand-alone HRAs or other arrangements to reimburse employees for medical expenses other than insurance premiums.¹⁰

¹ Two of the market reform requirements of the Patient Protection and Affordable Care Act — the annual limit on benefits and the preventive services market reform requirement — previously prohibited most HRAs that are not integrated with a group health plan.

² Under the Affordable Care Act, an applicable large employer is an employer that employed at least 50 full-time employees, including full-time equivalent employees, on business days during the preceding calendar year. Full-time equivalent employees include part-time employees, converted to a full-time basis.

³ Although the Act does not address whether an employee may receive reimbursement for health coverage obtained under a spouse's employer's group health plan, a 2015 Chief Counsel Memorandum (201547006) stated that reimbursement for such coverage will be allowed on a pre-tax basis only if the spouse paid for the coverage on an after-tax basis.

⁴ These amounts will be increased in \$50 increments based on changes in the Consumer Price Index for All Urban Consumers.

⁵ Permitted benefit means, with respect to any eligible employee, the maximum dollar amount of payments and reimbursements that may be made under the terms of the QSEHRA for the year with respect to such employee.

⁶ For church plans, it is unclear whether state continuation coverage laws will apply to QSEHRAs.

⁷ Coverage is affordable for a month if the excess of the amount that would be paid by the employee as the premium for such month for self-only coverage 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, does not exceed 1/12 of 9.5% of the employee's household income.

⁸ Minimum essential coverage is comprehensive health coverage that is necessary to avoid an individual penalty or employer shared responsibility penalty under the Affordable Care Act. Most employer group health plans and plans sold through the exchange provide minimum essential coverage.

⁹ Other laws (such as the Medicare secondary payer rules) may prohibit Medicare Part B or Part D reimbursements for certain employers.

¹⁰ As discussed in endnote 3 above, reimbursement from a QSEHRA for spousal health insurance will be allowed on a pre-tax basis only if the spousal insurance was purchased on an after-tax basis.