

Planning for 2020: Expanded HRA Options for Employers Under the Final HRA Regulations

The Departments of Labor, Health and Human Services and Treasury (the "Agencies") recently released final regulations¹ that create new opportunities for employers to provide health reimbursement arrangements ("HRAs") to employees. Beginning January 1, 2020, two new types of HRAs may be offered by employers under the final regulations, Individual Coverage HRAs and Excepted Benefit HRAs.

HRAs Prior to the Final Regulations

Generally, HRAs have long been a way for employers to provide tax advantaged reimbursements for certain health expenses to employees, with those reimbursements not being treated as taxable wages. Under prior guidance under the Affordable Care Act ("ACA"), HRAs (and other similar employer payment plans) are considered group health plans and could not be used to reimburse employees for premiums paid for individual coverage or other medical expenses (such as co-pays and deductibles) because the HRAs on a stand-alone basis could not comply with the ACA's market reforms (specifically the requirement to provide preventive care coverage and the prohibition on annual and lifetime dollar limits). Thus, prior to these new final regulations, it was necessary to "integrate" HRAs with group health plans or in limited circumstances with Medicare in order to comply with the ACA market reforms.

Individual Coverage HRAs

Individual Coverage HRAs are designed to extend the tax advantage for traditional employer-sponsored group health plans (*i.e.*, the tax-free nature of the premiums paid and benefits received under a group health plan) to HRA reimbursements of individual health insurance premiums. Under the final regulations, Individual Coverage HRAs are permitted to be "integrated"² with certain types of individual insurance coverage, including, but not limited to, individual coverage obtained both on and off the ACA marketplace, student health insurance coverage, individual catastrophic coverage, and Medicare, for purposes of satisfying ACA market reform requirements.

Who is eligible to participate in an Individual Coverage HRA? Employees (i) who are not eligible for employer sponsored group health coverage and (ii) who are enrolled in individual health insurance (or Medicare) may be eligible to participate in an Individual Coverage HRA. However, an employee who is only enrolled in short-term, limited-duration insurance or coverage that covers only excepted benefits (such as dental or vision) are not eligible to participate in an Individual Coverage HRA.

Can an Employer choose who is eligible for an Individual Coverage HRA? An employer is permitted to limit participation in an Individual Coverage HRA to certain objectively identifiable classes of employees. Under the final regulations, however, only the following constitute permissible classes of employees: full-time or part-time employees; salaried or non-salaried workers; seasonal employees; temporary employees; employees covered by a particular collective bargaining agreement; non-resident alien employees with no U.S. source income; employees who have not satisfied a waiting period; employees whose primary work site is in an insurance rating area, state or

¹ The final regulations were published in the Federal Register at 84 FR 28888 (available at this [link](#)).

² To be treated as "integrated" with eligible individual insurance coverage, for an employee to be eligible for HRA reimbursements, they must be enrolled in that individual coverage.

multi-state region; temporary employees of certain staffing firms; and any combination of the foregoing. Classes of employees are determined based on the common law employer (rather than on a controlled group basis). A “new hire” rule allows employers to offer an Individual Coverage HRA to new employees, while grandfathering existing employees in a traditional group health plan.

Is there a minimum class size? Yes, but only if an employer offers a traditional group health plan to some employees as well as an Individual Coverage HRA to other classes of employees. In that instance, a minimum class size rule for the Individual Coverage HRA will apply to the extent the class(es) of employees eligible for the Individual Coverage HRA are based on: (i) full-time versus part-time status; (ii) salaried versus non-salaried status; or (iii) geographic location (if the location is smaller than a state); or any combination of the foregoing. The minimum class size depends on the size of the employer and is (x) 10 employees, for employers with fewer than 100 employees, (ii) 10% of the total number of employees for employers with 100 to 200 employees, and (iii) twenty employees, for an employer with more than 200 employees. Our understanding is that employer size is determined based on the common law employer (rather than on a controlled group basis).

What expenses can be reimbursed? Any medical care expenses (including premiums for individual medical coverage) as defined in Section 213(d) of the Code can be reimbursed by an Individual Coverage HRA, but employers are not required to permit reimbursement of all such medical care expenses. Employers are permitted to limit the expenses eligible for reimbursement under an Individual Coverage HRA to be any narrower subset of any Section 213(d) medical care expenses.

Are there any limits to reimbursements, and can employee contributions be made? Generally, there is no legal limit to the level of Individual Coverage HRA reimbursements that may be made in a plan year. An employer can contribute any amount to an Individual Coverage HRA to reimburse medical care expenses incurred by an employee subject only to the maximum dollar amount set by the employer from year to year. However, employers must generally offer the same terms to all members of a class of employees (subject to limited exceptions where the amounts provided under an Individual Coverage HRA can be larger for older workers and workers with more dependents). Employers are also permitted to allow employees to make salary reduction contributions to an Individual Coverage HRA through a Section 125 cafeteria plan in order to purchase individual coverage outside of the ACA marketplace.³

Can unused amounts be rolled over? Employers may allow unused amounts in an Individual Coverage HRA in any year to roll over from year to year. The terms of the Individual Coverage HRA must specifically provide for the terms and conditions of any roll over.

What other requirements apply to Individual Coverage HRAs?

Notice. Employers must provide a written notice to employees eligible for the Individual Coverage HRA at least 90 days before the beginning of each plan year. For participants who become eligible mid-year, the written notice must be sent to them no later than the date the Individual Coverage HRA becomes effective for them. The written notice must contain specific information required by the final regulations (including, among other things, an explanation of the Individual Coverage HRA terms, the maximum annual allocation, an explanation of the different kinds of HRAs, the ERISA status of the Individual Coverage HRA, the impact of participation on ACA premium tax credit availability, and information related to the employee’s substantiation obligation). The Agencies have published a [model notice](#) that can be used by employers to meet this requirement.

³ A specific prohibition in Code Section 125(f)(3) does not permit cafeteria plan benefits to be used to purchase individual coverage from the ACA marketplace, but that prohibition does not apply to individual coverage outside of the ACA marketplace.

Substantiation. Employees participating in an Individual Coverage HRA must substantiate their enrollment in eligible individual health insurance annually and each time an employee seeks reimbursement for a medical care expense. Employees are permitted to self-certify that they have met the individual health insurance coverage requirement. The Agencies have published a [model annual substantiation form](#) that may be used for these purposes.

Opt Out. Participating in an HRA (including an Individual Coverage HRA) makes an employee ineligible for the ACA premium tax credit, and consistent with the traditional HRA rules, employees must be given the opportunity to opt out of an Individual Coverage HRA at least once per year.

How does an "Applicable Large Employer" satisfy the ACA employer mandates by offering an Individual Coverage HRA? Proposed regulations from the IRS⁴ issued at the end of September 2019 clarify the interplay between the offering of an Individual Coverage HRA to employees and the employer shared responsibility provisions of Section 4980H of the Code for "applicable large employers" (generally those employers with 50 or more full-time equivalent employees in the preceding year, or "ALEs"). Generally, under the employer shared responsibility provisions, in order to avoid ACA penalties, ALEs:

- (a) must offer minimum essential coverage (or "MEC") to at least 95 percent of its full-time employees; and
- (b) must offer coverage that meets the "affordability" and "minimum value" tests.⁵

The proposed regulations provide that simply offering the Individual Coverage HRA can be treated as an offer of MEC, satisfying the requirement noted at (a) above.

With respect to the second requirement described at (b) above, the proposed regulations deem an Individual Coverage HRA as providing coverage that has "minimum value" and is "affordable" if the benefit is enough to make the lowest-cost individual silver policy available through the ACA marketplace rating area in which the employee lives pass the affordability test for that particular year (*i.e.*, net cost to employee, after considering application of their HRA benefit to the lowest-cost silver plan premium, does not exceed 9.78% of household income in 2020). However, the premiums charged for the lowest-cost silver policy can vary based on a number of factors (*e.g.*, rating area, age bands, plan year, etc.) and the proposed regulations provide for a number of safe harbors and simplifying assumptions (in addition to other generally applicable safe harbors under the regulations and guidance relating to the "affordability" test under Section 4980H(b)) that employers may use for purposes of determining whether the benefit offered under an Individual Coverage HRA meets the affordability test.⁶

Employers who are not ALEs are not required to comply with the employer shared responsibility provisions of the ACA under Section 4980H of the Code.

⁴ Proposed regulations were issued by the Department of Treasury on September 30, 2019, available at 84 FR 51471 (available at this [link](#)).

⁵ Under guidance related to Section 4980H(b), generally (i) coverage is "affordable" if the cost to the employee (taking into account any employer subsidies) of the lowest-cost, self-only health plan offered by the employer does not exceed 9.78% (for 2020, but indexed annually) of the employee's household income and (ii) coverage offers "minimum value" if the plan's share of the total allowed costs for covered benefits equals at least 60% of the cost for a typical self-funded group health plan on an actuarial basis.

⁶ For example (among other safe harbors and simplifying assumptions available under the proposed regulations): (i) employers may use a location safe harbor and rely on the rating area of the primary site of employment for the employees, rather than the rating area of each employee's residence which may differ from where they primarily work; (ii) the age of an employee on the first day of the plan year of (or, if later, the first date of eligibility for) the Individual Coverage HRA may be used for the entire plan year; (iii) the lowest cost silver plan for the lowest age band in the individual market for the employee's location can be treated as the applicable lowest-cost silver plan premium; and (iv) for Individual Coverage HRAs that have a calendar year plan year, the monthly premium of the lowest-cost silver plan on the first day of the prior calendar year may be used for the entire plan year.

Does participation in an Individual Coverage HRA impact health savings account (“HSA”) eligibility?

Participation in an Individual Coverage HRA may impact HSA eligibility, but it depends on the terms of the Individual Coverage HRA. An Individual Coverage HRA can be narrowly designed to be compatible with HSA eligibility (e.g., by limiting reimbursements solely to the cost of individual health insurance coverage). Thus, for example, so long as the employee otherwise meets the requirements for HSA eligibility (i.e., the individual has high deductible health plan (“HDHP”) coverage, including using an Individual Coverage HRA to pay for an individual HDHP, and has no other disqualifying coverage) the employee would be eligible to contribute to an HSA.

However, an Individual Coverage HRA that is not designed to be limited in this manner and reimburses first dollar cost sharing (therefore, constituting disqualifying coverage) would cause the individual to not be eligible for an HSA. The final regulations provide that an employer can offer both an HSA-compatible Individual Coverage HRA and a non-compatible Individual Coverage HRA to employees without failing to meet the “same terms” requirement as long as both types of Individual Coverage HRAs are offered to all employees in the same class.

What are the differences between an Individual Coverage HRA and other types of HRAs? Individual Coverage HRAs share some similarities with other account-based arrangements that existed prior to the final regulations such as traditional HRAs and Qualified Small Employer HRAs (“QSEHRAs”). Here we highlight some of the key differences between these arrangements and Individual Coverage HRAs:

Traditional HRA. Under the ACA and the regulations and guidance promulgated thereunder, a traditional HRA is a group health plan that must be integrated with other coverage (e.g., an employer’s group health plan or in limited circumstances Medicare) that meets the ACA market reform requirements. Thus, a traditional HRA is typically offered by an employer together with the employer’s group health plan. In contrast, Individual Coverage HRAs can only be offered to a class of employees who are not eligible for an employer’s group health plan. Thus, the same group of employees cannot be eligible to participate in both a traditional HRA and an Individual Coverage HRA at the same time.

QSEHRA. Qualified Small Employer HRAs (“QSEHRAs”) are, by statute, not considered a group health plan and not subject to the ACA’s market reforms. Although QSEHRAs have some similarities with Individual Coverage HRAs, in that QSEHRAs must also generally be offered on the same terms to all employees subject to limited exceptions, QSEHRAs are exclusively employer-funded, subject to maximum annual contribution limits, and may only be offered by employers who have fewer than 50 full-time employees and who do not offer a group health plan to any of its employees. In contrast, Individual Coverage HRAs can be offered by employers of any size who otherwise maintain a group health plan for other employees, and Individual Coverage HRAs are not subject to limits on the amount of benefits that may be provided each year. Certain benefits under an Individual Coverage HRA can also be funded by employee pre-tax salary deferrals through a Section 125 cafeteria plan.

If an employee participates in an Individual Coverage HRA, when can the employee obtain individual coverage on the ACA marketplace? Generally, an individual can only enroll in ACA marketplace / exchange coverage during the annual open enrollment period or during certain special enrollment periods (i.e., generally a 60-day period following specific events, such as losing health coverage, certain changes in residence, getting married, having a baby or adopting a child). The final regulations create a new special enrollment period for employees and their dependents when they become covered by an Individual Coverage HRA (for example, if the employer establishes the Individual Coverage HRA mid-year, or a new hire becomes eligible for an Individual Coverage HRA mid-year).

Excepted Benefits HRAs

Excepted Benefit HRAs are designed to allow employers the opportunity to offer an arrangement that reimburses employees for certain benefits while at the same time offering that same group of employees (but not requiring enrollment in) the employer's group health plan coverage. An Excepted Benefit HRA is treated as a limited excepted benefit under the ACA⁷, which exempts the Excepted Benefit HRA from various ACA requirements (including the ACA market reforms that apply to group health plans) and, as a result, it is not necessary for an Excepted Benefit HRA to be integrated with group health coverage, individual health insurance coverage, or Medicare. An Excepted Benefit HRA, by itself, does not satisfy the ACA employer mandate that applies to ALEs.

Who is eligible to participate in an Excepted Benefit HRA? Employees who are offered the employer's group health plan coverage (although the employee need not be enrolled in the group health plan in order to participate in the Excepted Benefit HRA). The other group health plan coverage that is offered must not be limited to paying "excepted" benefits and cannot be an HRA or other account-based plan.

Can an Employer choose who is eligible for an Excepted Benefit HRA? An employer is permitted to limit eligibility for an Excepted Benefit HRA to "similarly situated individuals" (as defined in the HIPAA non-discrimination rules, which generally permits bona fide employment-base distinctions unrelated to health status). An Excepted Benefit HRA must be made available under the same terms to the same group of similarly situated individuals, but an employer can create distinct groups of similarly situated individuals for purposes of participation in Excepted Benefit HRAs under different terms (*i.e.*, the terms can vary on a group-by-group basis).

Is there a minimum class size? No.

What expenses can be reimbursed? An Excepted Benefit HRA can reimburse copays, deductibles, or other eligible medical expenses not covered by other insurance (whether or not they are "excepted" benefits), premiums for "excepted" benefits such as limited scope dental and vision coverage and short-term, limited-duration insurance, but cannot be used to reimburse individual health insurance premiums, Medicare premiums, or group health plan premiums (other than COBRA).

Are there any limits to reimbursements? Yes, the maximum benefit under an Excepted Benefit HRA will initially be limited in each plan year (for 2020, the limit is \$1,800). The limit will be indexed for inflation in future plan years after 2020.

Can unused amounts be rolled over? Employers may allow unused amounts in an Excepted Benefit HRA in any year to roll over from year to year. The terms of the Excepted Benefit HRA must specifically provide for the terms and conditions of any roll over.

What other requirements apply to Excepted Benefit HRAs? Unlike an Individual Coverage HRA, there are no advance notice, substantiation or opt out requirements for Excepted Benefit HRAs.

Does participation in an Excepted Benefit HRA impact HSA eligibility? The same rules mentioned above for Individual Coverage HRAs apply in the context of Excepted Benefit HRAs, in that so long as the employee otherwise meets the requirements for HSA eligibility (*i.e.*, the individual has high deductible health plan ("HDHP") coverage and has no other disqualifying coverage) the employee would be eligible to contribute to an HSA. Thus, for example, an employee that participates in an Excepted Benefit HRA that is available to pay premiums for short term, limited duration insurance (that otherwise constitutes HDHP coverage) and has no other disqualifying coverage would remain HSA eligible.

⁷ A plan that provides limited health benefits under a separate policy from a health plan, and not an integral part of the health plan is one of four categories of "excepted benefits" under the ACA.

What are the differences between an Excepted Benefit HRA and other similar arrangements? Excepted Benefit HRAs have some similarities with programs that existed prior to the final regulations such as limited purpose healthcare flexible spending accounts (“Limited Purpose FSAs”) and limited scope HRAs that reimburse only excepted benefits. Here we highlight some of the key differences between these arrangements and Excepted Benefit HRAs:

Limited Purpose FSAs. With Limited Purposes FSAs, either the employee or the employer can contribute to the account subject to annual limits (currently \$2,700 for 2019) and a Limited Purpose FSA cannot be used to reimburse premiums for coverage (although it can pay for deductibles and co-pays for dental and vision care). In addition, positive account balances under Limited Purpose FSAs generally do not carry over into subsequent years (*i.e.*, they are “use-it-or-lose-it”) except if the program is designed to meet specific exceptions. Limited Purpose FSAs cannot reimburse medical expenses that do not constitute “excepted” benefits (*i.e.*, reimbursements are generally limited to dental or vision expenses, and preventive care expenses).

In contrast, only employers contribute to an Excepted Benefit HRA subject to an annual limit of \$1,800 (for 2020). Excepted Benefit HRAs can be used to reimburse various kinds of non-covered medical expenses (not limited to dental and vision expenses) as well as premiums for certain types of coverage, and balances under an Excepted Benefit HRA can carry forward into subsequent years.

Limited Scope HRA that Reimburses Excepted Benefits. In addition, an Excepted Benefit HRA is different from a limited scope HRA that reimburses only excepted benefits (*e.g.*, limited scope dental and vision coverage only), which has no annual dollar limit but can only reimburse a smaller subset of expenses. Employers are permitted to continue to offer limited scope HRAs that reimburse only excepted benefits and those HRAs do not need to meet the requirements of an Excepted Benefit HRA.

Employers can begin offering Individual Coverage HRAs and Excepted Benefit HRAs to their employees beginning on January 1, 2020. The final regulations contain numerous complex rules and requirements that are beyond the scope of this alert so care should be taken before any Individual Coverage HRA or Excepted Benefit HRA is established that is intended to comply with the new rules.

This alert is for general informational purposes only and should not be construed as specific legal advice. If you would like more information about this alert, please contact one of the following attorneys or call your regular Patterson contact.

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