

The Affordable Care Act and HRAs, Health FSAs and Employer Reimbursements or Payments for Individual Health Insurance

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IRS Transition Relief for Small Employers Ends June 30, 2015

Like the driver who is surprised to learn that the "safe" speed that he has been driving is actually ten miles above the speed limit, many employers might be surprised to learn that a practice as innocuous as reimbursing or paying their employees' individual health insurance premiums actually violates the Affordable Care Act ("ACA"). The penalty that could be assessed on the employer for such violations can be financially devastating: \$100 per employee per day until the violation is corrected.¹ The IRS provided limited transition relief, however, for "Small Employers," as defined below. The relief is available to Small Employers for all of 2014 and for January 1 through June 30, 2015.²

Under the IRS's transition relief, Small Employers that reimburse or pay part of or all substantiated premiums for employees who purchase individual health insurance policies should stop doing so no later than June 30, 2015. Large employers that do this are not eligible for the transition relief and should stop this practice immediately. Employers that do not qualify for relief from the IRS could be liable for penalties for years beginning on or after January 1, 2014.

Employer-Sponsored Arrangements Subject to the ACA

The ACA imposes a number of requirements on insurance companies and employers that sponsor self-funded group health plans for their employees. For these purposes, a group health plan is not limited to major medical plans. The term "group health plan" also includes a health reimbursement arrangement ("HRA"), a flexible spending account for health expenses ("Health FSA"), and an arrangement under which an employer either reimburses an employee for substantiated premiums for individual health insurance coverage or pays the premiums for individual coverage directly to the insurance company (an "Employer Payment Plan").³

Exceptions to ACA Requirements

By design, HRAs, Health FSAs and Employer Payment Plans, standing alone, cannot satisfy certain requirements of the ACA. Specifically, these arrangements cannot comply with section 2711 of the ACA, which prohibits an annual limit on the dollar amount of benefits for any individual, or section 2713, which requires that the plan provide certain preventive services without imposing any cost-sharing requirements for those services. These arrangements may be structured, however, to be exempt from the ACA requirements. The following exceptions may apply.

HRA Integrated with Group Health Plan. If an HRA is "integrated" with other coverage as part of a group health plan and the other coverage alone would comply with the ACA, then the HRA complies with the applicable ACA requirements. An HRA is "integrated" with a group health plan if, under the terms of the HRA, the HRA is available only to employees who are covered by primary group health plan coverage provided by the employer or another employer, the HRA and the primary coverage both meet certain criteria, the employee is actually enrolled in the primary coverage, the HRA does not credit additional amounts to an individual when the individual is not enrolled in the primary coverage, an employee is permitted to permanently opt out of and waive future reimbursements from the HRA at least annually and, upon termination of employment, either the remaining amounts in the HRA are forfeited or the employee is permitted to permanently opt out of and waive future reimbursement from the HRA. *This exception is not met if an HRA is integrated with an individual health insurance policy (including an individual policy purchased on the ACA Health Insurance Marketplace at www.healthcare.gov), Medicare or TRICARE, or with an employer plan that provides coverage through individual policies.*

Arrangement that Provides Excepted Benefits (Including an EAP and Limited Wraparound Coverage). The ACA does not apply to a group health plan in relation to its provision of "excepted benefits," as defined in the statute and regulations. Excepted benefits include, but are not limited to, limited scope dental or vision benefits offered separately, coverage only for accident, disability or long-term care insurance, workers' compensation or similar insurance, automobile medical payment insurance, coverage for on-site medical clinics, an employee assistance plan or EAP that does not provide significant benefits in the nature of medical care or treatment, and coverage for a specified disease, e.g., a policy that provides a fixed payment if the insured gets cancer. Benefits provided to part-time employees, retirees and their dependents through a group health plan that wraps around eligible individual health insurance coverage are excepted benefits if certain conditions are met.

Health FSA. A Health FSA, like any other group health plan, that only provides excepted benefits, as defined in the statute and regulations, is not subject to the ACA. A Health FSA that is available to provide benefits other than the excepted benefits listed in the statute and regulations will, nevertheless, be treated as providing only excepted benefits if: 1) the Health FSA is offered under an employer's section 125 cafeteria plan; 2) the employer offers the participants in the Health FSA other group health plan coverage, not limited to excepted benefits, by reason of their employment; and 3) the Health FSA is structured so that the benefit payable to any participant in the Health FSA is not more than the greater of: a) \$500 plus the participant's salary reduction amount for the year; or b) two times the participant's salary reduction amount for the year.

Payroll Practice. An arrangement that has so little employer involvement that it would not be an "employee welfare benefit plan" or "welfare plan" under ERISA is not a "group health plan" for purposes of the ACA. A payroll practice of withholding part of an employee's compensation on an after-tax basis to pay premiums for individual health insurance directly to an insurance company at the employee's request will qualify for this exemption from the ACA if the practice meets the following criteria:

1. No contributions are made by the employer other than the after-tax salary reductions directed by the employee;
2. Participation in the program is completely voluntary for employees;
3. The sole functions of the employer, without endorsing the program, are to permit the insurer to publicize the program to employees, to collect premiums through payroll deductions and to remit the premiums to the insurer; and
4. The employer receives no consideration in the form of cash or otherwise in connection with the program, other than reasonable compensation, without profit, for administrative services actually rendered in connection with payroll deductions.

Retiree-Only or Single Employee Health Plan. The ACA requirements do not apply to a health plan that has fewer than two participants who are current employees on the first day of the plan year. Consequently, a health plan that only covers retirees or that only covers a single employee is not subject to the requirements.

Medicare Premium Reimbursement Arrangement. An arrangement under which an employer reimburses or pays some or all of its employees' and former employees' Medicare Part B or Part D premiums constitutes an Employer Payment Plan. Such an arrangement that has fewer than two participants who are current employees would qualify for the exemption from the ACA for single employee or retiree-only health plans described above. Such an arrangement that covers at least two current employees will satisfy the ACA requirements if: 1) the employer offers a group health plan (other than the Employer Payment Plan) to the Medicare-eligible employees that does not consist solely of excepted benefits and meets the "minimum value" standard of the ACA; 2) the employees participating in the Employer Payment Plan are actually enrolled in Medicare Parts A and B; 3) the Employer Payment Plan is available only to employees who are enrolled in Medicare Part A and Part B or Part D; and 4) the Employer Payment Plan is limited to reimbursement of Medicare Part B or Part D premiums and excepted benefits, including Medigap premiums.

TRICARE-Related HRA. TRICARE provides civilian health benefits to military personnel, military retirees, including some members of the Reserves, and their dependents. An arrangement under which an employer reimburses or pays some or all medical expenses for employees covered by TRICARE constitutes an HRA that is subject to the ACA if the arrangement covers two or more active employees. Such an arrangement will satisfy the ACA, however, if: 1) the employer offers a group health plan (other than the HRA) to the employees that does not consist solely of excepted benefits and meets the "minimum value" standard of the ACA; 2) the employees participating in the HRA are actually enrolled in TRICARE; 3) the HRA is available only to employees who are enrolled in TRICARE; and 4) the HRA is limited to reimbursement of cost-sharing and excepted benefits, including TRICARE supplemental premiums.

Increases in Employee Compensation to Assist with Individual Health Insurance Coverage

If an employer increases an employee's compensation, but does not condition the payment of the additional compensation on the purchase of health coverage or otherwise endorse a particular policy, form, or issuer of health insurance, the arrangement is not an Employer Payment Plan or other form of group health plan that is subject to the ACA requirements. The extent of this safe harbor, however, is not clear. Does it apply, for example, if the increase in compensation is conditioned on the employee's unsubstantiated representation that the employee has health insurance coverage from another source? We recommend that employers not condition compensation on any such representation, whether or not substantiation is required.

Temporary Relief for Small Employers

The IRS will not assess penalties against a "Small Employer" that pays or reimburses its employees for individual health insurance premiums or Medicare Part B or Part D premiums between January 1, 2014 and June 30, 2015. For purposes of this temporary relief, a "Small Employer" is an entity that employed an average of fewer than 50 full-time employees (including full-time equivalent employees) during a period of at least six consecutive calendar months, as chosen by the employer, during 2013, for purposes of determining the employer's status in 2014, and during 2014, for purposes of determining the employer's status in 2015.

Temporary Relief for S Corporations

It is not clear whether the ACA requirements apply to an arrangement described in IRS Notice 2008-1 under which an S corporation pays for or reimburses premiums for individual health insurance coverage for employees who are 2% shareholders of the S corporation and the payment or reimbursement is included in the shareholder-employees' income. (The shareholder-employees may deduct the amount of the premiums under section 162(l) of the Internal Revenue Code.) Until further guidance is issued, and at least through the end of 2015, the IRS will not assess penalties against any such arrangement that does not comply with the ACA.

Examples of Arrangements that Violate the ACA

- An employer's reimbursement of substantiated individual health insurance premiums under an Employer Payment Plan, whether on a pre-tax or after-tax basis
- A stand-alone HRA that limits the amount of health care reimbursement to the amount credited to the employee's HRA
- An HRA that is integrated with individual health insurance, Medicare or TRICARE
- An employer's direct payment of individual health insurance premium to an insurer on a pre-tax basis
- An employer's direct payment of individual health insurance premium to an insurer on an after-tax basis under an arrangement that is not simply a payroll practice, as described above, because, for example, participation is not voluntary or the insurer is selected or otherwise endorsed by the employer

Examples of Arrangements That *DO NOT* Violate the ACA

- An increase in an employee's compensation to assist with the purchase of individual health insurance, as long as the additional compensation is not conditioned on the purchase of health coverage and the employer does not endorse a particular policy, form, or issuer of health insurance
- An HRA that is properly integrated with a group health plan
- An employer payroll practice of forwarding employees' wages after-tax to a health insurance issuer at the direction of the employees without further employer involvement
- An HRA or Employer Payment Plan that consists solely of "excepted benefits"
- A Health FSA that is offered through a section 125 cafeteria plan and that limits the benefit payable to any participant to not more than the greater of: 1) \$500 plus the participant's salary reduction amount for the year or 2) two times the participant's salary reduction amount for the year, provided the employer offers employees covered by the Health FSA other group health plan coverage that is not limited to excepted benefits
- An arrangement that, on the first day of the plan year, has fewer than two participants who are current employees, e.g., a plan that only covers retirees
- An employee assistance program or EAP that does not provide significant benefits in the nature of medical care or treatment

¹ Internal Revenue Code § 4980D

² IRS Notice 2015-17, 2015-10 IRB 845, 02/18/2015

³ IRS Notice 2013-54, 2013-40 IRB 287, 09/13/2013
