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# New Law Clears the Way for Small Businesses to Offer Standalone HRAs

When President Obama signed into law the 21st Century Cures Act on December 13, 2016, most of the media coverage focused on the provisions related to medical innovation. But the law also includes some good news for small businesses that have been prohibited in recent years from providing their employees with Health Reimbursement Arrangements (HRAs). Specifically, beginning January 1, 2017, qualified small employers can use HRAs to reimburse employees who purchase individual insurance coverage, rather than providing employees with costly group health plans.

## The Need for HRA Relief

Employers can use HRAs to reimburse their workers' medical expenses, including health insurance premiums, up to a certain amount each year. The reimbursements are excludable from employees' taxable income, and untapped amounts can be rolled over to future years. HRAs generally have been considered to be group health plans for tax purposes.

The Affordable Care Act (ACA) prohibits group health plans from imposing annual or lifetime benefits limits and requires such plans to provide certain preventive services without any cost-sharing by employees. According to previous IRS guidance, "standalone HRAs" — those not tied to an existing group health plan — didn't comply with these rules, even if the HRAs were used to purchase health insurance coverage that did comply. And businesses that provided the HRAs were subject to fines of $100 per day for each affected employee.

The IRS position was troublesome for smaller businesses that struggled to pay for traditional group health plans or to administer their own self-insurance plans. The changes in the 21st Century Cures Act give these employers a third option for providing one of the benefits most valued by today's employees.

## A New Kind of HRA

The law incorporates an earlier bill known as the Small Business Healthcare Relief Act in creating an exception from the ACA penalties for "Qualified Small Employer Health Reimbursement Arrangements" (QSEHRAs). These HRAs won't be treated as group health plans. Employees won't be required to pay taxes on the employer's contribution, nor will the employer be liable for payroll taxes on it.

QSEHRAs must satisfy the following requirements:

- The employer has fewer than 50 full-time employees, meaning it isn't an "applicable large employer" subject to the employer shared-responsibility provision under the ACA.
- The employer doesn't offer a separate group health plan to any of its employees.
- The HRA is provided on the same terms to all eligible employees, except that an employee's benefit can vary based on criteria such as age and family size.
- The HRA is funded solely by the employer, with no salary-reduction contributions.
- The HRA provides payment or reimbursement for medical care expenses, which can include individual health insurance as well as out-of-pocket expenses.
- The amount of payments and reimbursements don't exceed $4,950 for individual employees or $10,000 for family coverage, subject to cost-of-living adjustments in future years. (The limits will be prorated for employees who aren't covered by the HRA for an entire year.)

In addition, when an employer offers an HRA, all employees generally must be eligible unless they're within their first 90 days on the job, under age 25, part-time or seasonal workers, covered in a collective bargaining unit, or certain nonresident aliens.

## Notice and Reporting Requirements

Employers that offer QSEHRAs must comply with some notice requirements. At least 90 days before each plan year begins (or on the first day a new employee is eligible), the employer must provide eligible employees a notice stating:

- The amount of the employee's permitted benefit under the HRA for the year,
- That the employee should provide information about that amount to any Health Insurance Exchange to which the employee applies for advance payment of the premium assistance tax credit (also referred to as a federal subsidy), and
- That, if the employee isn't covered under the minimum essential coverage for any month, the employee may be subject to tax under Internal Revenue Code Section 5000A for that month and reimbursements may be included in gross income.

Failure to provide timely notice will subject an employer to a $50 penalty for each employee, up to $2,500 annually. Notice will be considered timely for 2017 if provided by March 31, 2017.

In addition, employers must report the value of any QSEHRA benefit on employees' Forms W-2, beginning with forms issued in January 2018 for 2017. Future IRS guidance on such reporting is expected.

## Impact on Employee Subsidies

An employee's eligibility for subsidies for individual insurance will be affected by his or her eligibility for a QSEHRA. If the QSEHRA makes health insurance "affordable" (meaning Silver-level coverage would cost no more than 9.69% of the employee's household income), the employee won't qualify for a subsidy. If the QSEHRA doesn't make health insurance affordable, the employee can receive a subsidy but the amount will be reduced by the amount of the HRA benefit.

## On the Horizon

Although President-elect Trump and the Republican Congress have promised to repeal the ACA, the QSEHRA exception in the 21st Century Cures Act could complicate matters. If smaller employers take advantage of the exception, the individual insurance market is likely to expand and the risk pool is likely to diversify. This could both stabilize premiums and give more citizens a stake in preserving some of the ACA's provisions.

We are happy to discuss this with you and help you to better achieve your financial objectives. Feel free to reach out to your personal advisor or contact us at: cpas@dzhphillips.com or (415) 781-2500.