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Qualified Small Employer Health Reimbursement Arrangements FAQ

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On December 13, 2016, President Obama signed the [21st Century Cures Act](#) (Cures Act) into law. The Cures Act [provides a method](#) for certain small employers to reimburse individual health coverage premiums up to a dollar limit through HRAs called "Qualified Small Employer Health Reimbursement Arrangements" (QSE HRAs). The provision went into effect on January 1, 2017. On October 31, 2017, the IRS released [Notice 2017-67](#), providing guidance on the implementation and administration of QSE HRAs.

Unless an employer meets all the requirements for offering a QSE HRA, previous IRS guidance prohibiting the reimbursement of individual premiums directly or indirectly, after- or pre-tax, through an HRA, a Section 125 plan, a Section 105 plan, or any other mechanism, remains in full effect. Reimbursing individual premiums in a non-compliant manner will subject an employer to a Patient Protection and Affordable Care Act (ACA) penalty of \$100 a day per individual it reimburses, with the potential for other penalties based on the mechanism of the non-compliant reimbursement.

If an employer fails to meet the requirements of providing a QSE HRA, it will be subject to a penalty of \$100 per day per affected person for being a non-compliant group health plan. An arrangement will be a group health plan that is not a QSE HRA if it:

- Is not provided by an eligible employer (such as an employer that offers another group health plan to its employees).
- Is not provided on the same terms to all eligible employees.
- Reimburses medical expenses without first requiring proof of minimum essential coverage (MEC).
- Provides a permitted benefit in excess of the statutory dollar limits.

An arrangement's failure to be a QSE HRA will not cause any reimbursement of a properly substantiated medical expense that is otherwise excludable from income to be included in the employee's income or wages. Furthermore, an arrangement designed to reimburse expenses other than medical expenses (whether or not also reimbursing medical expenses) is neither a QSE HRA nor a group health plan. Accordingly, all payments under such an arrangement are includible in the employee's gross income and wages. An employer's failure to timely provide a compliant written notice does not cause an arrangement to fail to be a QSE HRA, but instead results in the penalty of \$50 per employee, not to exceed \$2,500.



Which employers may offer a QSE HRA?

Employers with fewer than 50 full-time and full-time equivalent employees (under ACA counting rules) that do not offer a group health plan. Employers that do not offer a group health plan, but offer a retiree-only plan to former employees may offer a QSE HRA.

Which employers may not offer a QSE HRA?

- Employers with 50 or more full-time and full-time equivalent employees (under ACA counting rules).
- Employers of any size that offer a group health plan, including plans that only provide excepted benefits, such as vision or dental benefits.
- Employers that provide current employees with access to money from health reimbursement arrangements (HRAs) offered in prior years (through a carry-over).
- Employers that offer employees access to carryover amounts in a flexible spending account (FSA).

What are the rules for employers in a controlled group?

- Employers with less than 50 full-time and full-time equivalent employees (under ACA counting rules) may offer QSE HRAs, with the headcount including all employees across an entire controlled group.
- If one employer within a controlled group offers a QSE HRA, it must be offered to all employees within the entire controlled group (or each employer must offer an identical QSE HRA).

Which employees may participate?

- Employers must offer the QSE HRA to all similarly situated employees.
- It is acceptable to provide different reimbursement amounts to different employees within the reimbursement limits, as long as the variance is due to variant prices in the insurance policies in which the individual employees are enrolled.
- It is not acceptable to provide different reimbursement amounts to employees based on employee classifications, seniority, job performance, wellness program incentives, or any other type of incentive/reward program.
- Employers do not have to offer QSE HRAs to part-time or seasonal employees, under the definition set in the income tax regulations. Under those regulations, part-time employees are those who work 35 hours or less per week, if others with similar work have substantially more hours; or those whose customary annual employment is less than 9 months, if others with similar work have substantially more months. Furthermore, employees who work less than 25 hours a week or less than 7 months out of the year will be considered part time or seasonal.



What, if any, nondiscrimination rules apply?

- Internal Revenue Code (IRC) Section 105 non-discrimination rules apply, so employers must ensure that a QSE HRA does not discriminate in favor of highly compensated or key employees. This test must be satisfied every plan year.
- It is best practice to run the test prior to the beginning of the plan year, several months before the end of the plan year, and at the close of the plan year.
- QSE HRAs must be offered on the same terms to all eligible employees. The arrangement must be operated on a uniform and consistent basis, with the only allowable exception being offering different reimbursements between employees based solely on the differences within the expenses they submitted for reimbursement.

What benefits can a QSE HRA pay for or reimburse?

- Any documented healthcare expenses as defined by Section 213(d) of the IRC. Unlike traditional HRAs, a QSE HRA may reimburse individual premiums.
- A QSE HRA can only reimburse the individual for expenses incurred during the period the individual is covered by the QSE HRA.
- A QSE HRA can reimburse an individual for over-the-counter drugs purchased without a prescription, however, the reimbursement would be taxable.

Can a QSE HRA offer a run-out period?

Yes. A QSE HRA can have a run-out period that is offered to all eligible employees on a uniform and consistent basis, allowing for submission of claims after the end of the coverage period, but only for claims that occurred during the coverage period.

Can a QSE HRA offer a carry-over?

Yes. A QSE HRA can allow individuals to carry over unused funds from year to year, however, the amount carried over will count toward the total eligible reimbursement amount for the new year.

A QSE HRA can reimburse employees for premium costs for individual plans. Can a QSE HRA reimburse employees for premium costs for enrollment in a spouse's group health plan?

Yes, however the reimbursement is taxable to the extent that the share of the spouse's premium was paid on a pre-tax basis.

A QSE HRA can reimburse employees for premium costs for individual plans. Are there requirements on where the policy is purchased?

- No. Employees can be reimbursed for individual coverage that they purchase from a broker, or for coverage that they purchase in the Marketplace or on the Exchange.
- The QSE HRA can only reimburse MEC policies that are available for purchase by at least one eligible employee.
- The QSE HRA can reimburse employees for Medicare and Medigap policies, so long as the QSE HRA is not available only for Medicare reimbursement.



How are expenses reimbursed?

The employee submits substantiated expenses to the claims administrator.

How are expenses substantiated?

The employee can follow the substantiation requirements for FSAs, unless the employer pays the health insurance issuer directly. If the employer pays the issuer directly, no substantiation is necessary.

If an expense is reimbursed without substantiation, then all reimbursements made on or after the date of the unsubstantiated claim will be taxable. An employee can cure the reimbursement of an unsubstantiated expense by repaying the unsubstantiated amount with after-tax funds.

How does an employee provide proof of coverage?

The proof must be provided for each individual whose expenses are eligible for reimbursement before the first reimbursement is provided. Proof may be:

1. A document from a third party (the insurer) showing the employee and the individual have coverage (such as an insurance card or an explanation of benefits) and an attestation by the employee that the coverage is MEC; or
2. An attestation by the employee stating that the employee and individual have MEC, the date the coverage began, and the name of the coverage provider.

With each reimbursement, the employee must attest that the employee and individual continue to have MEC.

This proof and attestation requirement is an annual requirement. Failure to require proof and collect proof and attestations would make the reimbursement taxable.

Are there limits on reimbursable expenses?

- Yes. In 2017, the reimbursement may not exceed \$4,950 annually for single coverage, and \$10,000 annually for family coverage. In 2018, the reimbursement may not exceed \$5,050 for single coverage and \$10,250 for family coverage. In 2019, the reimbursement may not exceed \$5,150 for single coverage and \$10,450 for family coverage. In 2020, the reimbursement may not exceed \$5,250 for single coverage and \$10,600 for family coverage.
- The amount is prorated by month for individuals who are not covered by the arrangement for the entire year.
- For non-calendar year QSE HRAs, the statutory dollar limits are prorated based on the number of months in each portion of the two calendar years in which the QSE HRA is provided. However, for practical implementation, a QSE HRA may use the statutory dollar limits applicable on the first day of the plan years for the entire plan year. If an arrangement assumes statutory dollar limits in excess of the actual



indexed dollar limits for the applicable year, the arrangement will fail to be a QSE HRA.

- The 2017 monthly limit for single coverage reimbursement is \$412. For 2018, it is \$420. For 2019, it is \$429. For 2020, it is \$437.
- The 2017 monthly limit for family coverage reimbursement is \$833. For 2018, it is \$854. For 2019, it is \$870. For 2020, it is \$883.
- The limits will be updated annually.

Will a QSE HRA impact an employee's subsidy eligibility in the Marketplace?

- Yes, if the QSE HRA offers affordable coverage, then an individual will not be subsidy eligible.
- Potentially, if the QSE HRA offers unaffordable coverage. In that case, an individual's subsidy eligibility would be reduced by the dollar amount provided for the month through the QSE HRA.

How are QSE HRAs funded?

A QSE HRA can only be funded by an employer. Employees cannot contribute to QSE HRAs on a pre- or post-tax basis. Employers should avoid plan designs that provide incentive/reward money to employees through a QSE HRA that is not provided to all similarly situated employees on a uniform basis, or requires employees to meet additional requirements to "earn" the money.

How is affordability calculated for a QSE HRA?

- Affordability will be determined by calculating the "net cost of coverage" to the employee.
- Net cost of coverage is the amount an employee would pay for self-only coverage under the lowest cost silver plan offered in the Marketplace minus the reimbursement from the QSE HRA.
- If the net cost of coverage is less than 9.78 percent of household income for 2020 (9.83 percent for 2021), coverage is affordable. If it is more costly, the coverage is unaffordable.

Example:

For 2020, an employer provides a QSE HRA with a self-only permitted benefit of \$3,960 and a family permitted benefit of \$8,040. An employee has a spouse and a dependent. The employee enrolls in a qualified health plan (QHP) that covers all three family members and is provided an \$8,040 permitted benefit. The annual premium for the second-lowest cost self-only silver plan offered by the employee's Marketplace is \$6,000. The employee's household income is \$20,000, and 9.78 percent of household income equals \$1,956.

Even though the employee receives the family permitted benefit of \$8,040, the self-only permitted benefit of \$3,960 is used to



determine whether the QSE HRA constitutes affordable coverage for the employee. The QSE HRA does not constitute affordable coverage for the employee for any month of 2020 because $1/12$ of the second-lowest cost self-only silver plan ($1/12 \times \$6,000 = \500) minus $1/12$ of the self-only permitted benefit ($1/12 \times \$3,960 = \330) equals \$170 ($\$500 - \$330 = \170), which is greater than $1/12$ of 9.78 percent of the employee's 2019 household income ($1/12 \times \$1,956 = \163). Thus, the employee may be allowed a premium tax credit for 2019 for coverage for the employee and the employee's family.

If an employee with a QSE HRA receives a subsidy, is the employer at risk for penalties?

No, because employers with fewer than 50 full-time and full-time equivalent employees are not obligated to provide coverage under the ACA.

Are QSE HRAs subject to COBRA?

No.

Are QSE HRAs subject to ERISA?

A QSE HRA is excluded from the ERISA Title I, Part 7 group health plan definition. The rest of ERISA may apply to QSE HRAs, although this issue remains undetermined by an administrative agency or court.

However, starting on January 1, 2020, individual coverage selected by the employee in the individual market and reimbursed by a QSE HRA will not be treated as a part of any employee welfare benefit plan for purposes of ERISA's Title I, if the QSE HRA meets the conditions in this [final rule](#) that was issued by the Department of Treasury, Department of Labor, and Department of Health and Human Services.

Do employers have any notice requirements if they offer a QSE HRA?

Yes. QSE HRA benefits have an annual notice requirement. Written notice must be provided to all eligible employees no later than 90 days prior to the beginning of the benefit year.

On February 27, 2017, the IRS issued [Notice 2017-20](#) that delayed the initial written notice deadline. On October 31, 2017, the IRS issued [Notice 2017-67](#) that stated an employer that provides a QSE HRA in 2017 or 2018 must provide written notice to eligible employees by the later of February 19, 2018, or 90 days before the first day of the plan year of the QSE HRA.

Newly eligible employees must be furnished with their written notice on or before the first day they are eligible to participate the QSE HRA.

What information must be contained in the written notice?

- The dollar amount the individual is eligible to receive through the QSE HRA. Newly eligible employees with prorated benefit amounts must receive notice that either includes the prorated amount or states that amounts are prorated based on the months of coverage, and provides the necessary information to calculate the correct prorated amount.



- A statement that the eligible employee should provide information about the QSE HRA to the Marketplace or Exchange if the employee has applied for an advance premium tax credit.
- A statement that employees who are not covered by minimum essential coverage (MEC) for any month may be subject to penalty.

Does an employer that offers a QSE HRA have reporting requirements?

- Employers sponsoring QSE HRAs must report money provided through a QSE HRA on an employee's W-2 under the [aggregate cost of employer-sponsored coverage](#).
- The employer must report the amount of payments and reimbursements the eligible employee is *entitled* to receive, using code "FF" in Box 12, without regard to the amount of payments actually received.
- It is unclear if the existing safe harbor on reporting the aggregate cost of employer-sponsored coverage for employers with fewer than 250 W-2s would apply, as arguably many of the small employers eligible to offer QSE HRAs would have fewer than 250 W-2s.

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