COMPLIANCE BULLETIN

IRS Issues New Guidance on Qualified Small Employer HRAs

OVERVIEW

On Oct. 31, 2017, the Internal Revenue Service (IRS) issued Notice 2017-67 to provide comprehensive guidance on a variety of topics regarding qualified small employer health reimbursement arrangements (QSEHRAs). Small employers that do not maintain group health plans may establish QSEHRAs for their employees, effective for plan years beginning on or after Jan. 1, 2017. Unlike other health accounts, QSEHRAs can be used to reimburse employees for their health insurance premiums.

Notice 2017-67 clarifies the technical rules for QSEHRAs, including the requirements that employees provide proof of minimum essential coverage (MEC) and that employers provide a written notice to eligible employees each year.

ACTION STEPS

Small employers with QSEHRAs should confirm that their QSEHRAs comply with this new guidance. Notice 2017-62 applies to plan years beginning on or after Nov. 20, 2017. In addition, employers may need to provide their initial written notice by Feb. 19, 2018.

HIGHLIGHTS

- QSEHRAs must be carefully designed to comply with IRS requirements.
- Eligible employees cannot waive QSEHRA coverage.
- If a QSEHRA only reimburses health insurance premiums, a covered individual will still be eligible for HSA contributions.
- The IRS has provided sample language for the QSEHRA notice.

IMPORTANT DATES

January 1, 2017
Small employers without group health plans may start providing QSEHRAs.

February 19, 2018
Deadline for employers that have implemented QSEHRAs to provide the initial written notice.

Provided By:
The Insurance Exchange

THE INSURANCE EXCHANGE
Since 1967
www.TIE-inc.com

Background

Beginning Jan. 1, 2017, employers that are not applicable large employers under the Affordable Care Act and do not maintain group health plans may sponsor QSEHRAs to pay for employees' individual health insurance policies and other out-of-pocket medical expenses on a tax-favored basis. To qualify as a QSEHRA, the reimbursement arrangement must meet the following criteria:

Employers that establish QSEHRAs for 2017 or 2018 may need to provide employees with an initial written notice by Feb. 19, 2018, or risk penalties from the IRS.

- ✓ The QSEHRA must be **funded solely by the employer**. Employees cannot make their own salary reduction contributions.
- ✓ QSEHRA payments or reimbursements must be limited to medical care expenses incurred by the employee or the employee's family members, after the employee provides **proof of coverage**.
- ✓ The maximum amount of payments and reimbursements from the QSEHRA for any year cannot exceed $4,950 (or $10,000 for QSEHRAs that also reimburse medical expenses of the employee's family members). These amounts are adjusted annually for inflation. For 2018, the total amount of payments and reimbursements from a QSEHRA cannot exceed $5,050 ($10,250 for family coverage).
- ✓ The QSEHRA must be provided on the **same terms** to all eligible employees.

IRS Guidance on QSEHRAs – Notice 2017-67

Notice 2017-67 provides detailed guidance on a wide range of topics for QSEHRAs, including the criteria for QSEHRAs, the tax consequences of the arrangement, the impact on eligibility for health savings account (HSA) contributions and the written notice requirement.

The guidance applies for **plan years beginning on or after Nov. 20, 2017**, although QSEHRAs established before that date may rely on this guidance. Also, employers that established QSEHRAs for 2017 in accordance with a reasonable good faith interpretation of the law may continue to operate their QSEHRAs based on those terms until the last day of the plan year that began in 2017.

Written Notice

An employer funding a QSEHRA for any year must provide a **written notice** to each eligible employee at least 90 days before the beginning of each year. For employees who become eligible to participate in the QSEHRA during the year, the notice must be provided by the date on which the employee becomes eligible to participate. If an employer fails to provide this notice for a reason other than reasonable cause, the employer may be subject to a penalty of $50 per employee for each failure, up to a maximum annual penalty of $2,500 for all notice failures during the year. On Feb. 27, 2017, the IRS delayed the initial notice deadline pending its issuance of further guidance.

Notice 2017-67 provides a **new deadline for the initial QSEHRA notice**, as well as **sample language** that employers may use.

> ***Initial Notice Deadline*** – An eligible employer that provides a QSEHRA during 2017 or 2018 must provide the initial written notice to eligible employees by the later of (1) **Feb. 19, 2018**, or (2) **90 days** before the first day of the QSEHRA's plan year. According to the IRS, penalties may apply to any employer that does not timely provide the written notice.

Same Terms Requirement

Notice 2017-67 explains what it means for a QSEHRA to be provided on the same terms to all eligible employees. For example, to satisfy this requirement:

- ✓ The QSEHRA must be operated on a uniform and consistent basis for all eligible employees;
- ✓ Eligible employees cannot be allowed to waive coverage; and
- ✓ If an employer is part of a controlled group or affiliated service group (as determined under Internal Revenue Code Section 414), each employer in the group must provide a QSEHRA to all eligible employees on the same terms.

In addition, Notice 2017-67 confirms that a QSEHRA may be designed to limit reimbursements to certain medical expenses (for example, health insurance premiums or cost-sharing expenses that are medical expenses). However, a QSEHRA will fail to satisfy the same terms requirement if, under the facts and circumstances, the plan's reimbursement limit causes the QSEHRA not to be effectively available to all eligible employees. This may occur, for example, if a QSEHRA limits reimbursements to Medicare or Medicare supplement policies.

Maximum Benefit and Reimbursements

QSEHRAs may use the statutory dollar limits in effect for the preceding year to determine permitted benefits, rather than the dollar limits in effect for the current year. IRS Notice 2017-67 also confirms that any carryovers of unused amounts from a prior plan year are taken into account when determining an employee's maximum annual benefit. An employee's total permitted benefit, taking into account both carry-over amounts and newly available amounts, may not exceed the applicable statutory dollar limit.

In addition, a QSEHRA may reimburse premiums for coverage under the group health plan of a spouse's employer. However, the reimbursement is taxable to the extent that the spouse's share of premiums was paid on a pre-tax basis.

Proof of Coverage

Before a QSEHRA can reimburse an expense for any plan year, the eligible employee must first provide proof that he or she had MEC for the month during which the expense was incurred. This proof must consist of either:

- ✓ A document from a third party (for example, the insurer) showing that the employee had coverage (for example, an insurance card or explanation of benefits) and an attestation by the employee that the coverage was MEC; or
- ✓ An attestation by the employee stating that the employee had MEC, the date the coverage began and the name of the coverage provider.

Notice 2017-67 includes **model attestation language** that employers may use. The initial proof of MEC must be provided with respect to each individual whose expenses are eligible for reimbursement before the first expense reimbursement. Following the initial proof, the employee must attest with each new request for reimbursement during the plan year that the employee and the individual whose expenses are being reimbursed (if different) continue to have MEC. This attestation can be part of the form for requesting reimbursement.

Employer Reporting

Employers that sponsor QSEHRAs must report the amount of payments and reimbursements that an eligible employee is entitled to receive from the QSEHRA for the calendar year in box 12 of the employee's Form W-2 using code FF, without regard to the payments or reimbursements actually received. Notice 2017-67 provides detailed rules for this reporting.

In addition, Notice 2017-67 confirms that an employer providing a QSEHRA is not required to provide IRS Forms 1095-B (Section 6056 statements) to covered employees. However, a QSEHRA is subject to the Patient-Centered Outcomes Research Institute (PCORI) fee, which applies for plan years ending before Oct. 1, 2019.

HSA Contributions

Employers that sponsor QSEHRAs may contribute to employees' HSAs and may allow employees to make pre-tax HSA contributions through a Section 125 plan.

Notice 2017-67 also addresses how QSEHRA coverage impacts an individual's eligibility for HSA contributions. To be HSA-eligible, an individual must be covered by a high deductible health plan (HDHP) and not be covered by other health coverage that provides benefits below the HDHP minimum deductible. According to the IRS, if the QSEHRA only reimburses health insurance premiums, it will not cause an individual to be ineligible for HSA contributions. However, individuals who are covered by QSEHRAs that reimburse any medical expenses, including cost sharing, are not eligible for HSA contributions.