Qualified Small Employer HRA Basics

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Overview

QSEHRAs are exempt from the Affordable Care Act's market reforms. To be a QSEHRA, the arrangement generally must:

- Be **funded solely by an eligible employer** without salary reduction contributions;
- Provide—after an eligible employee provides **proof of minimum essential coverage—** payment or reimbursement of qualified medical expenses (which includes premiums for other health coverage, such as **individual health insurance**) incurred by the employee or his or her family members;
- Limit annual payments and reimbursements to **$4,950 per employee (increased to $5,050 for 2018) or $10,000 per family (increased to $10,250 for 2018)**, and prorated where coverage is less than the entire year; **and**
- Be provided on the **same terms to all eligible employees.**

As outlined below, additional requirements apply to employers sponsoring QSEHRAs.

Eligibility Rules

Eligible Employers

To be an eligible employer that may provide a QSEHRA, the employer must **not**:

1. Be an applicable large employer as defined in the ACA's "pay or play" regulations. Thus, the employer may not be one that, generally, employed **at least 50 full-time employees** (including full-time equivalent employees) in the prior calendar year.

2. **Offer a group health plan** (including a health reimbursement arrangement, a health flexible spending arrangement, or a plan that provides only excepted benefits such as a vision or dental health plan) to any of its employees.

Thus, applicable large employers and employers who offer a group health plan must still comply with prior agency guidance.

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Eligible Employees

Any **employee** of an eligible employer is eligible to participate in a QSEHRA. This does not include retirees, other former employees, or non-employee owners. In addition, employers **may** exclude employees who:

- Have not completed 90 days of service;
- Have not attained age 25;
- Are part-time or seasonal;
- Are covered by certain collective bargaining agreements; and
- Are nonresident aliens whose income did not come from a U.S. source.

An eligible employee may not waive participation in a QSEHRA. Federal law requires eligible employers to **provide**, rather than **offer**, a QSEHRA on the **same terms** to all eligible employees. To satisfy the "same terms" requirement, the IRS has stated that:

1. The maximum amount of payments or reimbursements that may be made under the QSEHRA during the year to a particular employee (the "permitted benefit") **may vary** from employee to employee **based only on the age of covered individuals <u>or</u> the number of individuals covered** in accordance with the variation in the price of an insurance policy in a relevant individual health insurance market. This insurance policy must be both minimum essential coverage (MEC) and available for purchase by at least one eligible employee.

2. The QSEHRA must be operated on a **uniform and consistent basis** with respect to all eligible employees. However, a QSEHRA does not fail to be operated on a uniform and consistent basis merely because different eligible employees who are provided the same permitted benefit are reimbursed different amounts because they submitted different expenses for reimbursement.

Contribution Rules

QSEHRAs are funded **solely through employer contributions** and may not be funded through employee salary deferrals under a cafeteria plan. In general, payments from a QSEHRA to reimburse an eligible employee's medical expenses are not included in the employee's gross income if the employee has coverage that provides minimum essential coverage (MEC).

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For 2017, QSEHRA payments and reimbursements must not exceed **$4,950 per employee or $10,000 per family**. For 2018, QSEHRA payments and reimbursements must not exceed **$5,050 per employee or $10,250 per family**.

A QSEHRA may allow for amounts from a prior plan year to be carried over to the current plan year. However, an employee's total permitted benefit, taking into account both carryover amounts and newly available amounts, may not exceed the limits listed above.

Distribution Rules

In general, payments and reimbursements from a QSEHRA must only be made **after** the proof of minimum essential coverage and substantiation requirements discussed below have been satisfied.

Proof of Minimum Essential Coverage Requirement

Before a QSEHRA can reimburse an expense for any plan year, an eligible employee must first provide proof that the eligible employee and (if different) the individual whose expense will be reimbursed has minimum essential coverage (MEC) for the month during which the expense was incurred.

Examples of MEC include (among others):

- Individual health insurance policies purchased on the Health Insurance Marketplace;
- Individual health insurance policies purchased directly from an insurance company;
- Medicare Part A coverage;
- Medicare Advantage plans;
- Most Medicaid coverage;
- Children's Health Insurance Program (CHIP) coverage;
- Most types of TRICARE coverage; or
- Comprehensive health care programs offered by the U.S. Department of Veterans Affairs.

Specific Requirements

Proof of MEC must consist of either:

- A document from a third party (for example, the insurer) showing that the employee and the individual have coverage (for example, an insurance card or an explanation of benefits) and an attestation by the employee that the coverage is MEC; or

- An attestation by the employee stating that the employee and the individual have MEC, the date coverage began, and the name of the coverage provider.

When to Provide Proof of MEC

The initial proof of MEC must be provided **at least annually** with respect to each individual whose expenses are eligible for reimbursement **before the first reimbursement of an expense of that individual**.

Additionally, following the initial proof of coverage, with **each new request for reimbursement** of an incurred expense for the same plan year, at a minimum, the employee must attest that the employee and the individual whose expense is being reimbursed continue to have MEC (for example, as part of the form for requesting reimbursement).

Sample Attestation Forms

Click here to download a sample attestation form for initial proof of MEC. Click here to download a sample attestation form for continued MEC.

Substantiation Requirement

All claims for expense reimbursements must be substantiated. If an eligible employer pays an issuer directly for an employee's premium payment, no additional substantiation is required in relation to these payments. Otherwise, an employee may satisfy the substantiation requirement by complying with the substantiation requirements for FSAs as proposed at § 1.125-6. (Click here to access these rules and refer to page 43962.)

If the QSEHRA mistakenly reimburses an employee for a medical expense that has not been substantiated, **all payments to all employees under the QSEHRA, substantiated and unsubstantiated, on or after the date the mistaken reimbursement was made, become taxable.** However, if an employee timely substantiates or repays an unsubstantiated amount with after-tax funds, the QSEHRA will not be treated as failing to satisfy the substantiation requirements.

Written Notice Requirement

In general, an employer who provides a QSEHRA to its employees must furnish a written notice to each eligible employee **at least 90 days before the beginning of each year** or, for an employee

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who is not eligible to participate at the beginning of the year, the date on which the employee is first eligible to participate in the QSEHRA.

Timing Requirements for 2017 & 2018

However, an employer that provides a QSEHRA during 2017 or 2018 must furnish the initial written notice to its eligible employees by the later of:

- February 19, 2018; or
- 90 days before the first day of the plan year of the QSEHRA.

In the case of a newly eligible employee, the initial written notice must be furnished **on or before the first day the employee becomes eligible to participate in the QSEHRA**.

Content Requirements

The written notice generally must include:

- A statement of the amount of each permitted benefit for which the employee might be eligible and the date on which the QSEHRA is first provided to the eligible employee;
- A statement that the eligible employee must inform any Health Insurance Marketplace to which he or she applies for advance payments of the premium tax credit of the amount of the permitted benefit, that the amount of the permitted benefit may affect the eligibility for and amount of any premium tax credit, and that the employee should retain the written notice to calculate the premium tax credit on the employee's individual income tax return; and
- A statement that if the eligible employee does not have MEC for any month, the employee may be liable for an individual shared responsibility payment, and reimbursements under the QSEHRA for expenses incurred in the month will be includible in gross income.

Click here to download a sample written notice.

Electronic Distribution

An employer may furnish the written notice electronically (for example, by email) to its eligible employees if the employer follows the federal rules for the use of electronic media.

Noncompliance Penalty

Failure to satisfy the written notice requirement may result in penalties of **up to $50 per employee**, up to a maximum of $2,500 per calendar year per employer.

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Form W-2 Reporting Requirement

An employee's permitted benefit must be reported on his or her Form W-2. To satisfy this requirement, an employer must report the amount of payments and reimbursements that the eligible employee is entitled to receive from the QSEHRA for the calendar year in **box 12 of the Form W-2 using code FF**, without regard to the amount of payments or reimbursements actually received. For example, if a QSEHRA provides a permitted benefit of $3,000, but the employee only receives reimbursements of $2,000 from the QSEHRA, the employer must still report a permitted benefit of $3,000 in box 12 of Form W-2 using code FF. In addition, the permitted benefit reported on the employee's Form W-2 should include only newly available amounts, and should not include carryover amounts from prior years.

PCORI Reporting Requirement

Sponsors of QSEHRAs are subject to the Patient-Centered Outcomes Research Institute (PCORI) fee. As a result, QSEHRA sponsors must generally file Form 720, *Quarterly Federal Excise Tax Return*, annually by July 31 of the year following the last day of the plan year. For more information on the PCORI fee, please click here.

Noncompliance Penalties

If an arrangement fails to be a QSEHRA because, for example, it is not provided by an eligible employer, it is not provided on the same terms to all eligible employees, it reimburses medical expenses without first requiring proof of MEC, or it provides benefits in excess of the annual limits, it is subject to the rules applicable to group health plans. Any violation of these rules **may result in an excise tax of $100 per affected person per day**.

An employer's failure to timely provide a compliant written notice does not cause an arrangement to fail to be a QSEHRA, but instead results in penalties of **up to $50 per employee**, up to a maximum of $2,500 per calendar year per employer.

Additional Information

- IRS Notice 2017-67
- ACA FAQs Part 35 (pp.4-7)

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