



## IRS Releases Additional Guidance on Qualified Small Employer Health Reimbursement Arrangements (QSEHRAs)

Issue Date: December 2017

On October 31, 2017, the IRS issued a series of questions and answers ([Notice 2017-67](#)) regarding the requirements for Qualified Small Employer Health Reimbursement Arrangements (QSEHRAs). The 59-page document contains 79 questions covering various topics with respect to QSEHRA administration and compliance. The guidance is likely to form the basis of forthcoming proposed regulations regarding QSEHRAs. The guidance applies to plan years beginning on or after November 20, 2017, and public comments will be accepted through January 19, 2018.

### Background

The 21st Century Cures Act (“Act”), passed and signed into law in December of 2016, included a provision creating QSEHRAs. The purpose of a QSEHRA is to allow small employers who do not offer group health insurance to their employees to provide tax-free money to employees that can be used to pay for individual health insurance policies and to reimburse employees for certain medical expenses. On December 20, 2016, the IRS, DOL, and HHS collectively issued an [FAQ](#) to provide initial guidance regarding the requirements for QSEHRAs. Last month, Executive Order 13813 (82 Fed. Reg. 48385, Oct. 17, 2017) directed the agencies to consider revising guidance to increase the usability of health reimbursement arrangements (HRAs); expand employers’ ability to offer HRAs to their employees; and allow HRAs to be used in conjunction with non-group coverage. The purpose of Notice 2017-67 is to address those objectives, although the agencies anticipate issuing further guidance in the future in response to Executive Order 13813.

### Summary

This new guidance does not change the basic requirements for a QSEHRA originally outlined in the Act and the December 20thFAQ. (We originally described these requirements [in this notice](#).) Notice 2017-67 expands upon the existing requirements to provide detailed guidance for applying them. Below is a summary of the topics addressed in the guidance:

#### *Eligible Employer*

To offer a QSEHRA, an employer cannot qualify as an Applicable Large Employer (ALE) under the IRS §4980H rules. For employers who become ALEs, they fail to qualify to offer a QSEHRA as of January 1 of the year that they are first an ALE. Eligible employers cannot offer a group health plan to their employees unless it consists only of excepted benefits. Employers who are members of a controlled group fail to be eligible employers if any member of the controlled group offers a group health plan to its employees.

#### *Eligible Employees*

A QSEHRA must be offered to all eligible, non-excludable employees. Former employees, retirees, and more than 2% shareholders who are employees are not eligible to participate in a QSEHRA. An employer may exclude: employees during their first 90 days of employment; employees who haven’t attained age 25 before the beginning of the plan year; employees covered by a collective bargaining agreement if health benefits were the subject of good faith bargaining; part-time employees (i.e., customarily working less than 25 hours/week, or less than 35 hours/week if others doing similar work have more hours); seasonal employees (i.e., customarily working fewer than 7 months/year, or fewer than 9 months/year if other employees doing similar work have substantially more months); and nonresident aliens with no earned income from sources within the U.S.

Eligible employees are not permitted to waive participation in a QSEHRA. If a formerly excludable employee becomes eligible, the employer must offer the QSEHRA no later than the first day following the date the employee becomes eligible.

### ***Same Terms Requirement***

An employer must offer a QSEHRA on the same terms and conditions to all eligible employees. The maximum reimbursement may vary according to age or family size only if the pricing variations are based on an individual market policy (a “baseline policy”) that constitutes minimum essential coverage (MEC) and is available to at least one employee. Alternatively, employers may reimburse up to a single dollar amount regardless of whether an eligible employee has single or family coverage, or may provide reimbursements up to the self-only and family statutory dollar limits (described below) or up to an equal percentage of the limits without referring to a baseline policy.

As part of the “same terms” requirement, an employer must make the permitted family reimbursement amount to any employees whose family members also have MEC, even if they’re covered under separate policies. And individuals who are employees of the same employer and members of the same family are each separately entitled to the permissible reimbursement amount for family coverage; however, if all were covered by a single-family policy, their aggregate premium reimbursements would be limited to one full family premium.

### ***Statutory Dollar Limits***

A QSEHRA cannot provide reimbursements that exceed the statutory dollar limits, which are indexed for inflation for years after 2016. The indexed dollar limits for 2017 are \$4,950 for self-only coverage and \$10,050 for family coverage. Since the indexed amounts will not be available until October of each year, and because written notice is required ninety (90) days prior to the start of the plan year, employers may rely on the prior year’s indexed amounts when determining permitted benefit for the current year.

If the QSEHRA contains a carryover provision, the carryover and the new year’s permitted benefit combined cannot exceed the applicable statutory dollar limit.

The guidance contains special rules regarding the process for prorating the permitted benefit amount for non-calendar year plans and short plan years, as well as for employees who are eligible for only a portion of the year.

For purposes of calculating the permitted benefit, employers may round to the nearest whole number in increments of \$50, not to exceed the annual statutory dollar limit.

### ***Written Notice***

An eligible employer that provides a QSEHRA during 2017 or 2018 must furnish the initial written notice to its eligible employees by the later of: 1) February 19, 2018; or 2) 90 days before the first day of the plan year of the QSEHRA. Except for those deadlines, the notice must be furnished to newly eligible employees on or before the first day on which QSEHRA participation can begin. The written notice must contain the following elements:

1. A statement of the amount of each permitted benefit for which the employee might be eligible.
2. If the permitted benefit varies based on the number of family members covered under the arrangement or their ages, the notice may include either each available permitted benefit, or the permitted benefit for which that employee is eligible.
3. In the case of a newly eligible employee whose permitted benefit has been prorated, the written notice must either include the prorated permitted benefit or state that the amounts are prorated based on the months of coverage and provide the information necessary to calculate the prorated amount.

4. A statement that the eligible employee must inform any Marketplace to which the employee applies for premium tax credits of the amount of the permitted benefit.
5. A statement 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 because it may be needed to calculate the premium tax credit on the employee's income tax return.
6. A statement that if the eligible employee doesn't have MEC for any month, the employee may be liable for an individual shared responsibility payment, and that reimbursements under the QSEHRA for expenses incurred in the month will be includible in gross income.

Notwithstanding the delayed due date for the written notice, employers are encouraged to issue the notice as soon as possible for employees who will be making decisions that may be affected by the information. Absent reasonable cause, employers are subject to a notice failure penalty of \$50 per employee, per incident, up to \$2,500 per year.

#### ***Minimum Essential Coverage (MEC) Requirement***

In order to participate in a QSEHRA, an individual must be covered by MEC. Any amounts reimbursed by a QSEHRA for services incurred while an individual does not have MEC must be included in the employee's gross income.

#### ***Proof of MEC Requirement***

An employer offering a QSEHRA must require proof of MEC from all eligible employees and other individuals eligible for reimbursement before the QSEHRA reimburses any expenses. The proof must consist of either:

1. a document from a third party (e.g., the insurer) showing that the employee and the individual have coverage and an attestation by the employee that the coverage is MEC; or
2. an attestation by the employee stating that the employee and the individual have MEC, the date coverage began, and the name of the provider of the coverage.

The guidance contains a list of common types of MEC and a model form of attestation. After initial proof of MEC is provided, the employee must continue to attest that the employee and the individual requesting reimbursement continue to be covered by MEC prior to each reimbursement. Updated proof of MEC is required at least annually.

#### ***Substantiation Requirement***

The QSEHRA may provide reimbursement only for Section 213(d) medical expenses. Claims for expense reimbursements must be substantiated using the same process that applies to health FSAs or other IRS-approved methods. Reimbursements made for unsubstantiated claims will become taxable income to the employee, and all reimbursements, substantiated or not, made on or after that date to all employees will also be taxable. Similarly, reimbursements made for non-medical expenses will cause all payments to all employees on or after that date to become taxable. However, these adverse consequences may be avoided if the employee provides appropriate substantiation or an after-tax repayment, as appropriate, within certain timeframes.

#### ***Reimbursements***

Because reimbursements are excludable only to the extent to which they are used to reimburse medical expenses, year-end cash-outs of unused permitted benefits are not permitted.

QSEHRAs may be used to reimburse premiums under a separate individual market policy of a spouse or under a spouse's employer's group coverage (although reimbursements for the latter are taxable to the extent that the spouse pays their share or premiums on a pre-tax basis).

A QSEHRA may either make the full amount of the permitted benefit available at the beginning of the year, or may spread reimbursements throughout the year (e.g., by making the reimbursements available ratably on a month-by-month basis) as long as the “same terms” requirement is satisfied.

QSEHRAs may not reimburse medical expenses incurred (as determined by the date of service) before the eligible employee is provided the QSEHRA. Special rules apply to determining when a premium for expense for a period of coverage is considered incurred.

Over-the-counter drugs without a prescription may be reimbursed from a QSEHRA, but these reimbursements will be taxable.

Run-out periods are permitted. And the employer may arrange for after-tax payroll deductions to assist employees in paying premiums beyond amounts paid by the QSEHRA, so long as the employer does not endorse a particular policy, form, or issuer of individual health insurance (which would create a group health plan and disqualify the QSEHRA).

### ***Reporting***

An employer must report the permitted benefit 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 or any allowed carryover. The guidance addresses various scenarios with respect to calculating the appropriate permitted benefit for reporting purposes – i.e., reporting for employees who didn’t receive any reimbursements and whose permitted benefit could have varied; reporting for non-calendar year plans; reporting for employees whose permitted benefit changes midyear; reporting taxable reimbursements; and reporting mistaken reimbursements.

The guidance clarifies that an employer providing a QSEHRA is not required to provide a Form 1095-B with respect to the QSEHRA.

### ***Coordination with the Premium Tax Credit***

Neither employees nor their family members are eligible for premium tax credits for a month if the employee has a QSEHRA that constitutes affordable coverage. A QSEHRA constitutes affordable coverage for a month if the excess of the monthly premium for the self-only second lowest cost silver plan over 1/12 of the employee’s maximum permitted benefit for self-only coverage (i.e., the amount reported on the W-2, or in the QSEHRA notice if different amounts for self-only and family are provided) under the QSEHRA doesn’t exceed 1/12 of 9.5 percent (adjusted annually) of the employee’s household income.

If an employee is provided a QSEHRA (with other than affordable coverage), the premium tax credit otherwise allowable for the month (self-only or family, as applicable) is reduced by 1/12 of the permitted benefit available to the employee under the QSEHRA for the year.

Permitted benefits are not accounted for in Federally-Facilitated Marketplaces for 2017 or 2018, so employees receiving premium tax credits in those locations will need to consider adjustments in their use and reporting requirements on Form 8962.

### ***Failure to Satisfy the Requirements to Be a QSEHRA***

If an arrangement fails to be a QSEHRA due to one of the following factors, then the arrangement will be a group health plan subject to excise taxes of up to \$100 per affected person per day:

1. It is provided by an ineligible employer (i.e., an employer that offers another group health plan to its employees);
2. It is not provided on the same terms to all eligible employees;
3. It reimburses medical expenses without first requiring proof of MEC; or
4. It provides a permitted benefit in excess of the statutory maximum.

Failure to qualify as a QSEHRA will not cause reimbursement of a properly substantiated medical expense that is otherwise excludable from income to be included in the employee's income and wages. However, an arrangement that reimburses non-medical expenses (even if it also reimburses medical expenses) is neither a QSEHRA nor a group health plan, and all payments under such an arrangement are includable in the employee's gross income and wages.

***PCORI Fee***

A QSEHRA is an applicable self-insured health plan subject to the PCORI Fee under Section 4376 for years ending before September 30, 2019.

***Interaction with HSAs***

Coverage by a QSEHRA will cause an individual to be ineligible for an HSA unless the QSEHRA reimburses only premiums, permitted insurance, and/or disregarded coverage.

***Effective Date***

The guidance is effective on and applies to plan years beginning on or after November 20, 2017. QSEHRAs established before the effective date may rely on this guidance. However, transition relief is provided to employers offering QSEHRAs operating under a reasonable good faith interpretation of the statutory provisions. Such employers may continue to operate the QSEHRA according to its terms until the last day of the plan year that began in 2017 so long as the QSEHRA was established (i.e., adopted, provided, or written notice furnished) before November 20, 2017.

*Please be aware that this does not represent legal or tax advice and is only Frenkel's interpretation of the laws, regulations and statutes. It is highly recommended that you seek the advice of your legal and tax professional as to the applicability of this information to your particular situation.*