



Qualified Small Employer Health Reimbursement Arrangement

Issue Date: January 2017

The 21st Century Cures Act (“Act”), passed and signed into law in December, includes a provision creating what is called a “Qualified Small Employer Health Reimbursement Arrangement” (“QSEHRA”). A QSEHRA allows small employers who do not offer group health insurance to their employees to provide money to employees on a tax-free basis; the money can be used to pay for individual health insurance policies and to reimburse employees for certain medical expenses.

Background

Prior to the creation of QSEHRAs, Internal Revenue Service (IRS) guidance prohibited employers from offering stand-alone HRAs. According to the IRS, stand-alone HRAs would not comply with various ACA group market reform requirements. IRS guidance also prohibited employers from using an HRA to reimburse employees for premiums paid for individual health insurance coverage. This prohibition applied even if the reimbursements were treated as taxable income to the employee. Now, however, eligible small employers will be able to use a QSEHRA to help pay for an employee’s individual health insurance on a tax-free basis up to certain limits (described below).

Employers and Employees Eligible for a QSEHRA?

To offer a QSEHRA, a small employer must not qualify as an Applicable Large Employer (ALE) under the IRS §4980H rules. Generally, this means the employer must have fewer than 50 full-time equivalents (FTE) the previous calendar year. To be eligible to offer a QSEHRA, a small employer also cannot offer any other group health plan to its employees.

An eligible employer must offer the QSEHRA to all employees except:

- employees with fewer than 90 days of service;
- employees under the age of 25;
- part-time and seasonal employees (regulatory guidance is needed to define ineligible part-time and seasonal employees);
- union employees unless a collective bargaining agreement provides for eligibility; and
- employees who are non-resident aliens with no U.S. source income.

A QSEHRA must be funded solely by employer contributions. Employees may not make contributions to a QSEHRA and may not contribute to the QSEHRA on a pre-tax basis. Employers must offer the QSEHRA on the same terms to all of its employees. However, the employer is allowed to vary the reimbursements to employees based on rate variations in the price of an individual insurance policy due to age rating or family size.

Reimbursements under a QSEHRA

QSEHRAs are subject to a number of rules regarding reimbursements and the employee’s use of the tax-free reimbursements available through the plan.

- An employee who is covered by a QSEHRA may receive reimbursement for the employee’s and eligible family members’ medical expenses (as defined in IRC section 213(d)). The employee must provide the employer with proof of his or her medical expenses prior to receiving reimbursement under the QSEHRA.

- Eligible medical expenses include insurance premiums for individual insurance coverage. Employers could limit the reimbursements to individual health insurance premiums only. Although the QSEHRA can reimburse both unreimbursed medical expenses and individual premiums, it is expected that this arrangement will principally be used by employer to help fund the purchase of individual health insurance policies.
- The maximum amount of reimbursement that an employer can provide tax free to employees is \$4,950 per year for employee-only coverage or \$10,000 per year for family coverage. An employee is not taxed on the medical expense reimbursements received through a QSEHRA. However, if the employee does not have “minimum essential coverage,” then any reimbursements he or she receives through the QSEHRA are considered taxable and must be included in the employee’s gross income.
- Depending on the amount of reimbursement that an employee may receive from a QSEHRA, these reimbursement amounts may reduce (or completely eliminate) the amount of subsidy the employee (and spouse and dependent(s)) may receive through the Health Insurance Marketplace.

Employer Compliance Obligations

Notice Requirements

An employer must provide employees with a notice no later than 90 days before the beginning of the year (or the date that the employee is first eligible to participate in the QSEHRA). The notice must include:

- the amount available for reimbursement under the QSEHRA for the year;
- an explanation that if the employee applies for a Health Insurance Exchange premium assistance tax credit (i.e., subsidy), such employee must inform the Health Insurance Exchange of the amount he or she is eligible to receive through the QSEHRA; and
- a statement that if the employee is not covered under “minimum essential coverage” for any month, the employee may be subject to individual mandate penalties, and any reimbursements under the QSEHRA will be includible in the employee’s gross income.

Other Employer Compliance Obligations

Although a QSEHRA is not considered an ERISA “group health plan,” it is still an employee benefit arrangement that is subject to ERISA. Consequently, the employer will need to meet various ERISA obligations, such as the creation of plan documents. Employers must collect substantiation (e.g., receipts) from employees’ medical expenses or insurance premiums prior to reimbursing the expenses and must report the amount available for reimbursement under the QSEHRA on the employee’s Form W-2. Finally, since the QSEHRA is not considered a “group health plan,” it is not subject to federal COBRA rules.

Summary

While it is impossible to tell how many small employers who do not offer health insurance to their employees will be interested in the new QSEHRA arrangement, this is the first time that federal rules specifically allow employer funds to be provided tax free to an employee for the purchase of individual health insurance. It is also expected that the IRS will issue formal guidance to address some of the compliance and administrative details not specifically addressed in the statute.

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.