



COMPLIANCE BULLETIN

New Law Allows Stand-alone HRAs for Small Employers

HIGHLIGHTS

- Small employers that do not sponsor group health plans may adopt stand-alone HRAs, called QSEHRAs.
- Employees may use QSEHRAs to pay for health insurance policies and other out-of-pocket medical expenses.
- Specific requirements apply, including a maximum benefit limit and a notice requirement.

IMPORTANT DATES

January 1, 2017

QSEHRAs may be adopted for plan years beginning on or after Jan. 1, 2017.

OVERVIEW

On Dec. 13, 2016, the [21st Century Cures Act](#) (Act) was signed into law. The Act allows small employers that do not maintain group health plans to establish stand-alone health reimbursement arrangements (HRAs), effective for plan years beginning on or after Jan. 1, 2017. This new type of HRA is called a “**qualified small employer HRA**” (or QSEHRA).

Due to the Affordable Care Act (ACA), most stand-alone HRAs have been prohibited since 2014. This new law creates a special exception for small employers that are not subject to the ACA’s employer shared responsibility rules. Instead of offering a group health plan, small businesses may use a QSEHRA to reimburse employees’ out-of-pocket medical expenses, including their premiums for individual health insurance coverage, on a tax-free basis.

ACTION STEPS

Small employers that do not sponsor group health plans may want to consider implementing a QSEHRA to help their employees pay for out-of-pocket medical expenses. Because there are specific design requirements for these HRAs, including a maximum benefit limit and an employee notice, small businesses should work with their advisors to make sure their QSEHRAs are compliant.

Provided By:
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ACA Reforms

HRAs are employer-funded arrangements that reimburse employees for certain medical care expenses on a tax-free basis, up to a maximum dollar amount for a coverage period. The ACA includes market reforms that limit the availability of HRAs, beginning in 2014. Under these reforms, most stand-alone HRAs have been prohibited. A stand-alone HRA is an HRA that is not offered in conjunction with a group health plan.

However, the Act creates an exception to this prohibition for a new type of HRA—the QSEHRA. The Act provides that a QSEHRA is not a group health plan, which means QSEHRAs are not subject to the ACA’s market reforms that have limited the availability of stand-alone HRAs.

Beginning in 2017, small business owners have a new benefit option available to them—they can contribute to a stand-alone HRA instead of offering a group health plan.

Effective Jan. 1, 2017, an eligible employer may offer a stand-alone HRA without incurring penalties under the ACA if the HRA meets the requirements for a **QSEHRA**. This type of HRA can be used to help employees pay for their own health insurance policies and reimburse other out-of-pocket medical expenses.

Qualified Small Employer HRA

Eligible Employers

To be eligible to offer a QSEHRA, an employer must meet the following two requirements:

1. The employer is not an applicable large employer (ALE) that is subject to the ACA’s employer shared responsibility rules. In general, this means that the employer must have **fewer than 50 full-time employees, including full-time equivalents**.
2. The employer does not maintain a group health plan for any of its employees.

Design Requirements

Like all HRAs, a QSEHRA must be funded solely by the employer. Employees cannot make their own contributions to an HRA, either directly or indirectly through salary reduction contributions. In addition, the following requirements apply to QSEHRAs:

Maximum Benefit

- The **maximum benefit** available under 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 dollar amounts are subject to adjustment for inflation for years beginning after 2016.
- The maximum dollar limits must be prorated for individuals who are not covered by

Eligibility and Benefit Rules

Reimbursements

the QSEHRA for the entire year.

- The QSEHRA must be provided on the **same terms to all eligible employees** except:
 - The maximum benefit may vary based on age and family-size variations in the price of an individual policy in the relevant individual health insurance market; and
 - The QSEHRA may exclude certain categories of employees, including collectively bargained employees, employees who are part time or seasonal, employees who have not completed 90 days of service, employees who are younger than age 25 and non-resident aliens without earned income from sources within the United States.
- QSEHRA payments or reimbursements must be limited to medical care expenses (as defined in Tax Code Section 213(d)) incurred by the employee or the employee's family members, after the employee provides proof of coverage.
- This would include, for example, premiums for individual health insurance coverage and other out-of-pocket medical expenses.

Employee Notice

An employer funding a QSEHRA for any year must provide a **written notice** to each eligible employee. This notice must be provided at least **90 days** before the beginning of the 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.

The notice must include the following information:

- ✓ The employee's maximum benefit under the QSEHRA for the year;
- ✓ A statement that, if the employee is applying for advance payment of the premium assistance tax credit, the employee should provide the Exchange with information about the QSEHRA's maximum benefit; and
- ✓ A statement that, if the employee is not covered under minimum essential coverage for any month, the employee may be subject to a penalty under the ACA's individual mandate and reimbursements under the QSEHRA may be includible in gross income.

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.

As transition relief, the Act gave small employers until March 13, 2017, to provide the initial QSEHRA notice. However, on Feb. 27, 2017, the Internal Revenue Service (IRS) issued [Notice 2017-20](#) to delay the initial QSEHRA notice deadline until further guidance is provided. According to the IRS, the new deadline for providing the initial QSEHRA notice will be

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no earlier than 90 days following the issuance of this guidance. In the meantime, employers that provide the QSEHRA notice to their eligible employees may rely upon a reasonable good faith interpretation of the Act to determine the contents of the notice.

Transition Relief Extension

The Act also extends the transition relief under [IRS Notice 2015-17](#) so that it applies with respect to plan years beginning on or before Dec. 31, 2016. Notice 2015-17 provides that the excise tax for failing to satisfy the ACA's market reforms does not apply to employer payment plans sponsored by non-ALEs that pay, or reimburse employees for, individual health policy premiums or Medicare Part B or Part D premiums. That relief was limited to periods before July 1, 2015, and it did not apply to stand-alone HRAs that reimbursed employees for medical expenses other than insurance premiums.

On Dec. 20, 2016, the Departments of Labor, Health and Human Services and the Treasury (Departments) issued a set of [FAQs](#) addressing ACA implementation issues, including the Act's extension of this transition relief. According to these FAQs, for plan years beginning on or before Dec. 31, 2016, the ACA's excise tax does not apply to employer payment plans that are sponsored by non-ALEs and that pay, or reimburse employees for, individual health policy premiums or Medicare Part B or Part D premiums. However, consistent with Notice 2015-17, this transition relief does not apply to stand-alone HRAs that reimburse employees for medical expenses other than insurance premiums.