Employee Relations
LAW JOURNAL

Employee Benefits

Final Regulations Provide Employers with More Flexibility in Offering HRAs to Employees

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The Departments of Treasury, Labor, and Health and Human Services have jointly issued final regulations (the Final Regulations) providing employers with greater flexibility in offering health reimbursement arrangements (HRAs) to employees.[1] Specifically, employers will be able to offer employees an HRA that integrates with individual health insurance coverage, known as an Individual Coverage HRA.[2] As a result, these Final Regulations, in essence, enable employers to offer HRAs in lieu of a traditional group health plan to their employees. Additionally, the Final Regulations set forth conditions under which another type of HRA can be offered to employees who do not elect to participate in the employer's health plan, known as an Excepted Benefit HRA.[3]

The Final Regulations include a few changes from the proposed regulations issued on October 29, 2018,[4] including additional guidance on the available employee classifications that an employer may use when offering an Individual Coverage HRA to its employees.

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The Final Regulations generally apply for plan years beginning on and after January 1, 2020.[5]

Background

An HRA is a type of account-based group health plan funded solely by employer contributions (with no salary reduction contributions or other contributions by employees) that reimburses an employee solely for medical care expenses incurred by the employee, or the employee's spouse, dependents, and children (who have not attained age 27 as of the end of the taxable year), up to a maximum dollar amount for a coverage period.[6] An account-based group health plan is an employer-provided group health plan that provides for reimbursement of expenses for medical care (as defined under Section 213(d) of the Internal Revenue Code of 1986, as amended (the Code)) ("medical care expenses"), subject to a maximum fixed-dollar amount of reimbursements for a period (e.g., a calendar year).[7] The reimbursements under these types of arrangements are excludable from an employee's income and wages for federal income tax and employment tax purposes.[8] Depending on the terms of the HRA, amounts that remain in the HRA at the end of the year may be used to reimburse medical care expenses incurred in later years.[9]

When employers sponsor HRAs, the HRAs are typically established as unfunded "bookkeeping" accounts to reimburse eligible employees for medical care expenses that are not covered by group health insurance, such as deductibles and copayments.

The Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act of 2010 (collectively, the ACA) amended the provisions of part A of title XXVII of the Public Health Service Act (PHS Act) relating to health coverage requirements for group health plans and health insurance issuers in the group and individual markets.[10] The term "group health plan" includes both fully-insured and self-insured group health plans.[11] Section 2711 of the PHS Act, which was added by the ACA, generally prohibits group health plans and health insurance issuers offering group or individual health insurance coverage from establishing a lifetime or annual limit on the dollar value of essential health benefits (EHBs), as defined in Section 1302(b) of the ACA, for any individual.[12] Section 2711 of the PHS Act, does not prevent a group health plan, or a health insurance issuer offering group or individual health insurance coverage, from placing an annual or lifetime dollar limit for any individual on specific covered benefits that are not EHBs, to the extent these limits are otherwise permitted under applicable law.[13]

HRAs are subject to Section 2711 of the PHS Act. Generally, an HRA will fail to comply with Section 2711 of the PHS Act because the arrangement is a group health plan that imposes an annual dollar limit on EHBs that the HRA will reimburse for an individual.[14] If an HRA is "integrated"

with other group health plan coverage that complies with the PHS Act, the HRA would be considered in compliance with these requirements because the combined arrangement complies with the PHS Act.[15] Under previous guidance, HRAs could not be integrated with individual health insurance coverage for purposes of complying with the PHS Act.[16]

In order to expand access to HRAs, President Trump issued Executive Order 13813, "Promoting Healthcare Choice and Competition Across the United States," stating, in part, that the "Administration will prioritize three areas for improvement in the near term: Association health plans (AHPs), short-term, limited-duration insurance (STLDI), and health reimbursement arrangements (HRAs)."[17] With regard to HRAs, the Executive Order directs the Secretaries of Treasury, Labor, and Health and Human Services to "consider proposing regulations or revising guidance, to the extent permitted by law and supported by sound policy, to increase the usability of HRAs, to expand employers' ability to offer HRAs to their employees, and to allow HRAs to be used in conjunction with nongroup coverage."[18] The Executive Order further provides that "[e]xpanding the flexibility and use of HRAs would provide many Americans, including employees who work at small businesses, with more options for financing their healthcare."[19]

As directed in Executive Order 13813, on October 29, 2018, the Departments of Treasury, Labor, and Health and Human Services issued proposed regulations to expand the use of HRAs, including allowing HRAs to be integrated with certain individual health insurance coverage, and on June 20, 2019, the Departments issued the Final Regulations, after reviewing comments they received on the proposed regulations.[20]

Changes Imposed by the Final Regulations

The Final Regulations expand the use of HRAs in two important ways. First, the Final Regulations remove the current prohibition against integrating an HRA with individual health insurance coverage under Section 2711 of the PHS Act.[21] Instead, the Final Regulations permit an HRA to be integrated with individual health insurance coverage and be in compliance with the PHS Act, if certain conditions are met (an Individual Coverage HRA, or ICHRA).[22]

Second, the Final Regulations expand the definition of "limited excepted benefits" under Section 9832(c)(2) of the Code, Section 733(c)(2) of the Employee Retirement Income Security Act of 1974 (ERISA), and Section 2791(c)(2)(C) of the PHS Act, to recognize certain HRAs limited in amount and that are limited with regard to the types of coverage for which premiums may be reimbursed as limited excepted benefits if certain other conditions are met (an Excepted Benefit HRA, or EBHRA).[23] The Final Regulations provide that an employee does not need to enroll in a traditional group health plan in order to participate in an EBHRA.[24]

Individual Coverage HRAs

Under previous guidance, HRAs that were not integrated with group health coverage violated the ACA's prohibition against placing lifetime or annual limits on the dollar value of EHBs.[25] The Final Regulations provide an exception to this prohibition for HRAs that are integrated with individual health coverage, including coverage offered on the Exchange, provided that certain requirements are met.

In order to be an ICHRA, the HRA must require participants to enroll in individual health insurance that complies with the requirements of the PHS Act.[26] For this purpose, all individual health insurance coverage, except for individual health insurance coverage that consists solely of excepted benefits (e.g., plans that cover only dental or vision benefits), is treated as being subject to and complying with the PHS Act.[27] Additionally, reasonable procedures must be established to verify that individuals whose medical care expenses are reimbursable by an ICHRA are, or will be, enrolled in individual health insurance coverage (other than coverage that consists solely of excepted benefits) during the plan year.[28]

Under the Final Regulations, an employer may offer an ICHRA to a class of employees only if the employer does not also offer a traditional group health plan to the same class of employees.[29] This means that an employer may not allow employees to choose between enrolling in an ICHRA or enrolling in a traditional group health insurance.[30] If such a choice was permitted under the Final Regulations, then employers may try to incentivize their employees with health conditions ("higher risk employees") to accept the ICHRA and move to the individual market instead of enrolling in the employer's traditional group health plan. If employers were able to steer their higher risk employees to the individual market through an ICHRA, then the individual market risk pool would likely worsen and impact the price and selection of individual coverage on the Exchange.

Further, an employer must offer this ICHRA on the same terms to all employees in the same employee class.[31] Permitted classes of employees include full-time employees, part-time employees, seasonal employees, employees in a particular collective bargaining unit, employees who have not met a waiting period, employees of a temporary staffing agency, salaried employees, and non-salaried (e.g., hourly) employees.[32] When classifying part-time, full-time, and seasonal employees, employers may choose to use the definitions from the nondiscrimination regulations that apply to self-insured plans under Section 105(h) or 4980H of the Code.[33] Employers can create new classes by combining two or more of the abovementioned classes.[34]

To allay concerns raised in the comments to the proposed regulations that employers would use classes to segment higher risk employees into the individual market, the Final Regulations require that if an employer uses full-time employee, part-time employee, salaried

employee, and non-salaried employee classifications and certain classifications based on the geographic location of employees, then each class must contain a minimum number of employees in order to be a valid classification.[35] This minimum class size requirement varies with employer size and applies only where a plan sponsor that offers an ICHRA to at least one class of employees and also offers a traditional group health plan to at least one other class of employees.[36] The minimum number of employees that must be in a class of employees that is subject to the minimum class size requirement is determined prior to the beginning of the plan year for each plan year of the ICHRA.[37] To be a valid class, employers with fewer than 100 employees must have at least 10 employees within each classification; employers with 100 to 200 employees must have at least 10 percent of their employees (rounded down to the nearest whole number) within each classification; and employers with more than 200 employees must have at least 20 employees within each classification.[38] The minimum class size requirement does not apply to a class of employees offered a traditional group health plan or a class of employees offered no coverage.[39]

The Final Regulations provide that a plan sponsor that offers a traditional group health plan to a class of employees may prospectively offer the employees in that class of employees who are hired on or after a certain future date (a "new hire date") an ICHRA, while continuing to offer employees in that class of employees who are hired before the new hire date a traditional group health plan.[40] An employer can set different new hire dates for different classes of employees.[41] The ICHRA offered to new hire employees in a subclass must be offered on the same terms to all participants within the new hire subclass, and employees within that subclass may not be offered a choice between an ICHRA and a traditional group health plan.[42] However, the minimum class size requirement does not apply to a new hire subclass, unless an employer further subdivides a new hire subclass after it created such subclass.[43] An employer can discontinue any of its new hire subclasses at any time, in which case all employees in the discontinued new hire subclass will join the broader class (i.e., with employees hired before the new hire date) and will be offered the same health insurance benefits as other members of the broader class.[44]

By allowing employers to offer an ICHRA to new hires within an employee classification, while keeping existing employees in that same classification on a traditional group health plan, the Final Regulations enable employers to progressively ICHRAs to their employees without causing an abrupt transition.

Additionally, the Final Regulations provide that an employer may offer an ICHRA to some, but not all, former employees within a class of employees without violating the requirement that ICHRAs must be offered on the same terms to employees within a class.[45] However, if an employer does offer an ICHRA to one or more former employees in a

class, it must offer the ICHRA on the same terms to all employees within that class.[46]

The Final Regulations allow employers to design an ICHRA that allows the maximum dollar amount made available under an ICHRA to increase for participants within a class of employees as the age of a participant increases, provided that the same maximum dollar amount attributable to that increase in age is made available to all participants of the same age within the same class of employees and the maximum amount available to the oldest ICHRA participants must not exceed three times the maximum amount available to the youngest participants.[47] Similarly, the Final Regulations permit an ICHRA to be designed to allow the maximum dollar amount made available to participants to increase for participants within a class of employees as the number of a participant's dependents who are covered under the ICHRA increases, provided that the same maximum dollar amount attributable to that increase in family size is made available to all participants in that class of employees with the same number of dependents covered by the ICHRA.[48] Unlike the age increase exception to the requirement that an employer must offer an ICHRA on the same terms to all employees within a class, the family size exception does not have a fixed maximum-to-minimum ratio.[49]

ICHRA may also be integrated with Medicare provided that the ICHRA satisfies the abovementioned requirements of an ICHRA when replacing each reference to individual health insurance coverage with coverage under Medicare Part A and B or Part C (Medicare Part A and B are not sufficient on their own).[50] An employer cannot create separate classes for employees who are eligible for or enrolled in Medicare. Further, an individual and his/her dependents do not need to have the same type of coverage.[51] Therefore, an ICHRA may be integrated with Medicare for some individuals and with individual health insurance coverage for others (e.g., a participant enrolled in Medicare Part A and B or Part C and his or her dependents enrolled in individual health insurance coverage).[52]

Employers that sponsor an ICHRA must provide affected employees with a notice concerning the ICHRA.[53] This notice is designed to help these employees understand that being eligible to participant in an ICHRA may impact their eligibility to receive a premium tax credit for Exchange coverage. The notice must be provided at least 90 days before the beginning of each plan year and must describe, among other things,

(1) The terms of the ICHRA;

(2) The participant's right to opt out of the ICHRA and waive future reimbursements from it;

(3) The potential availability of the premium tax credit for Exchange coverage if the participant opts out of the ICHRA and if the ICHRA is deemed not affordable;

(4) A statement explaining that a participant's dependents may lose eligibility for premium tax credits for Exchange coverage for any month the participant is covered by the ICHRA;

(5) The participant's obligation to inform the Exchange of the availability of the ICHRA when applying for a tax credit;

(6) The participant's obligation to substantiate medical care expenses in order to be reimbursed by the ICHRA; and

(7) A statement that it is the responsibility of the participant to inform the ICHRA if the participant or any dependent whose medical care expenses are reimbursable by the ICHRA is no longer enrolled in individual health insurance coverage.[54]

The Final Regulations clarify that the individual health insurance coverage that is integrated with an ICHRA is not part of the employer's group health plan for purposes of ERISA, provided that:

(1) An employee's purchase of the individual health insurance coverage is voluntary;

(2) The employer does not endorse any particular insurance coverage;

(3) Reimbursement for nongroup health insurance premiums is limited solely to individual health insurance coverage;

(4) The employer receives no consideration in the form of cash or otherwise in connection with the employee's selection or renewal of any individual health insurance coverage; and

(5) The employer notifies the participant annually that the individual health insurance coverage is not subject to ERISA.[55]

Excepted Benefit HRAs

In addition to providing for a new HRA that is an ICHRA, the Final Regulations provide for a new Excepted Benefit HRA under which amounts newly made available for each plan year are limited to $1,800 (indexed for inflation for plan years beginning after December 31, 2020), provided that certain requirements are met.[56] EBHRAs are exempt from certain ERISA and ACA requirements, which allows them to be offered on a stand-alone basis without being integrated with group or individual medical coverage.[57] However, even though an

EBHRA does not need to be integrated with other coverage, in order to offer an EBHRA, an employer must offer its employees a group health plan that is not limited to excepted benefits and that is not an HRA.[58] The employees do not need to enroll in this group health plan, but it must be offered to them.[59] Not having to enroll in the employer's group health plan is a departure from traditional HRAs. Employees enrolled in an EBHRA could be reimbursed for any medical expense, other than premiums for individual health insurance coverage, group health plan coverage (other than COBRA, state, or other continuation coverage), or Medicare Parts A, B, C, or D.[60] However, the EBHRA could be used to pay premiums for coverage that consists solely of excepted benefits.[61]

Considerations for Employers

Under the Final Regulations, certain employers may be tempted to offer an ICHRA rather than a traditional group health plan. Such employers may experience reduced administrative costs since they would no longer need to choose and manage health insurance plans or self-insured health benefits for their employees.

If enough employers with large numbers of higher risk employees offer ICHRAs instead of traditional group health plans, then the increased risk in the individual market risk pool could impact the price and selection of individual coverage on the Exchange.

Offering an ICHRA may be able to help applicable large employers (ALEs) (i.e., employers with 50 or more full-time equivalent employees[62]) avoid having to pay the ACA's "pay or play penalty." In general, an employer will owe a payment under Section 4980H(a) of the Code if it fails to offer an eligible employer-sponsored plan to at least 95 percent of its full-time employees and their dependents and at least one full-time employee is allowed a premium tax credit for a month.[63] An ICHRA is considered an eligible employer-sponsored plan. Therefore, if an ALE offers an eligible employer sponsored plan (including an ICHRA) to at least 95 percent of its full-time employees and their dependents, the ALE would not be liable for a payment under Section 4980H(a) of the Code for each month such an offer is made. However, such an employer may still be liable for a payment under Section 4980H(b) of the Code if at least one full-time employee is allowed a premium tax credit, which may occur if the eligible employer-sponsored plan offered was not affordable or did not provide minimum value, or if the employee was not offered coverage.[64]

Smaller employers (i.e., employers with fewer than 50 full-time equivalent employees) are not subject to Section 4980H of the Code,[65] so such employers can offer an ICHRA without being concerned that such an offering is deemed affordable and provides minimum value.

An employer who wants to offer an HRA and does not want to require employees to substantiate their enrollment in individual health insurance

coverage may find an EBHRA to be an attractive option. However, an employer should note that in order to offer an EBHRA, an employer must still offer a group health plan that is not limited to expected benefits and that is not an HRA.

Conclusion

The Final Regulations allow HRAs to be integrated with individual health insurance coverage, provided certain conditions are met. Being able to offer an ICHRA provides all employers (i.e., ALEs and small employers) with more choices and opportunities to provide medical employee benefits to their employees. However, allowing employers to offer ICHRAs may be very disruptive from a human resources perspective and to the health insurance market. In addition, employers may be interested in offering an EBHRA alongside a traditional group health plan under certain conditions.

Employers should reach out to their legal counsel to learn more about ICHRAs and EBHRA and how to incorporate these HRAs into their employee benefit packages for employees, including designing an HRA program that complies with the ACA and the nondiscrimination provisions in the Final Regulations.

Notes

1. *See* 84 Fed. Reg. 28,888, 28,888 (June 20, 2019).
2. *See* Treas. Reg. § 54.9802-4(c).
3. *See* Treas. Reg. § 54.9831-1(c)(3)(viii).
4. *See* 83 Fed. Reg. 54420 (October 29, 2018).
5. *See* 84 Fed. Reg. at 28,888.
6. *See id.*
7. *See id.*
8. *See id.*
9. *See id.* at 28,888-89.
10. *See* Patient Protection and Affordable Care Act, Pub. L. No. 111-148, 124 Stat. 119, enacted on March 23, 2010.
11. *See* 84 Fed. Reg. at 28,889.
12. *See* 41 U.S.C. § 300gg-11.
13. *See* 84 Fed. Reg. at 28,889.
14. *See id.*

15. *See id.* at 28,890. The previous regulations and guidance also provide that HRAs may be integrated with Medicare and TRICARE coverage if certain conditions are met.

16. *See id.*

17. Exec. Order No. 13813, 82 Fed. Reg. 48,385, 48,385 (Oct. 17, 2017).

18. *Id.* at 48,386.

19. *Id.* at 48,385.

20. *See* 84 Fed. Reg. at 28,888.

21. *See* Treas. Reg. § 54.9802-4(c).

22. *See id.*

23. *See* Treas. Reg. § 54.9831-1(c)(3)(viii).

24. *See* Treas. Reg. § 54.9831-1(c)(3)(viii)(A).

25. *See* 41 U.S.C. § 300gg-11.

26. *See* Treas. Reg. § 54.9802-4.

27. *See* Treas. Reg. § 54.9802-4(c)(1)(i).

28. *See* Treas. Reg. § 54.9802-4(c)(5)(i).

29. *See* Treas. Reg. § 54.9802-4(c)(2).

30. *See id.*

31. *See* Treas. Reg. § 54.9802-4(c)(3).

32. *See* Treas. Reg. § 54.9802-4(d)(2). The proposed regulations allowed employers to create a separate class for employees who have not attained age 25, but this classification was not included in the Final Regulations. The Final Regulations provide for new classifications for salaried and non-salaried employees.

33. *See* Treas. Reg. § 54.9802-4(d)(4).

34. *See* Treas. Reg. § 54.9802-4(d)(2)(xi).

35. *See* Treas. Reg. § 54.9802-4(d)(3).

36. *See* Treas. Reg. § 54.9802-4(d)(3)(ii)(A).

37. *See* Treas. Reg. § 54.9802-4(d)(3)(iii)(A).

38. *See id.*

39. *See* Treas. Reg. § 54.9802-4(d)(3)(ii)(B).

40. *See* Treas. Reg. § 54.9802-4(d)(5)(i).

41. *See* Treas. Reg. § 54.9802-4(d)(5)(ii).

42. *See* Treas. Reg. § 54.9802-4(d)(5)(i).

43. *See* Treas. Reg. § 54.9802-4(d)(5)(iv).

44. *See* Treas. Reg. § 54.9802-4(d)(5)(iii).

45. *See* Treas. Reg. § 54.9802-4(c)(3)(iv).

46. *See id.*

47. *See* Treas. Reg. § 54.9802-4(c)(3)(iii)(B).
48. *See* Treas. Reg. § 54.9802-4(c)(3)(iii)(A).
49. *See id.*
50. *See* Treas. Reg. § 54.9802-4(e).
51. *See* Treas. Reg. § 54.9802-4(e)(1).
52. *See id.*
53. *See* Treas. Reg. § 54.9802-4(c)(6).
54. *See* Treas. Reg. § 54.9802-4(c).
55. *See* 29 C.F.R. § 2510.3-1(*l*).
56. *See* Treas. Reg. § 54.9831-1(c)(3)(viii).
57. *See* Treas. Reg. § 54.9831-1(c)(3).
58. *See* Treas. Reg. § 54.9831-1(c)(3)(viii)(A).
59. *See id.*
60. *See* Treas. Reg. § 54.9831-1(c)(3)(viii)(C).
61. *See id.*
62. *See* I.R.C. § 4980H(c)(2).
63. *See* Treas. Reg. § 54.4980H-4.
64. *See* I.R.C. § 4980H(b).
65. *See* I.R.C. § 4980H(c)(2).