ASURESOFTWARE

Qualified Small Employer HRA (QSEHRA)

What is a QSEHRA?

A QSEHRA is an employer-sponsored employee benefit plan under which the employer reimburses employees for healthcare related expenses incurred by the employees and their family members, subject to certain limitations and other rules.

Why adopt a QSEHRA?

After the passage of the Affordable Care Act (ACA) and the implementation of new markets providing individual health insurance policies, some employers that did not sponsor group health plans for their employees sought to help employees pay for the cost of their individual policies by reimbursing them for premiums paid on the policies. However, the IRS and other government agencies found that these “employer payment plans” constituted group health plans, and because they failed to meet all of the rules applicable to group health plans under the ACA, they were non-compliant plans for which the employer could be subject to excise taxes of $100 per employee per day. (See IRS Notice 2013-54.)

The QSEHRA was specifically created as a solution to the above-described dilemma, i.e., a way that employers could reimburse employees for premiums for individual health insurance policies and other medical expenses without running afoul of ACA requirements.

Which employers are eligible to adopt a QSEHRA?

An employer is eligible to adopt a QSEHRA only if (a) the employer had less than 50 full-time employees (counting full-time equivalents) in the prior calendar year, and (b) the employer does not maintain any group health plan covering any employees. For this purpose, the term “group health plan” is construed broadly to include plans such as dental plans, vision plans, and health flexible spending arrangements (FSAs) that are part of Section 125 cafeteria plans.

Who funds a QSEHRA?

Under a QSEHRA, the cost of the reimbursements for healthcare related expense must be funded exclusively by the employer. No reimbursements can be funded via employee salary reduction contributions, such as those traditionally made under a flexible spending arrangement (FSA) that is part of a Section 125 cafeteria plan.

What are the limits under a QSEHRA?

Reimbursements to an employee under a QSEHRA are limited to $4,950 per year for single coverage, or $10,000 per year for family coverage. (These statutory limits are adjusted for inflation each year. While the $4,950 limit remains unchanged for 2017, the $10,000 limit has already been adjusted to $10,050 for 2017. For 2018, the applicable limits are $5,050 and $10,250, respectively.)

The above-referenced limits are the maximums permitted under the law. However, an employer is free to design its QSEHRA to provide for any lower limits it might wish to impose. Also, an employer need not have a separate limit for family coverage. For example, an employer might wish to have a limit of $5,050 per employee in 2018, without regard to whether the employee’s policy is for single coverage or family coverage.

The annual limits must be prorated for an employee who is not covered by the QSEHRA for the entire year. For example, an employee who begins participation in the QSEHRA on May 1, 2018 with single coverage would be subject to a limit of $3,366.67 ($5,050 x 8/12) for 2018.

Which employees must be covered under a QSEHRA?

Generally, if an employer adopts a QSEHRA, all employees of the employer must be eligible to participate in the QSEHRA. However, an employee in any of the following specific categories can be excluded: (a) employees who have not completed 90 days of service with the employer, (b) employees who have not reached age 25 before the first day of the plan year, (c) part-time employees, (d) seasonal employees, (e) union employees for whom health benefits were the subject of good faith bargaining, and (f) nonresident aliens with no income from sources within the United States. Generally, “part-time” is defined to mean customary weekly employment of less than 25 hours.

Each of the above exclusions is permitted but not required in a QSEHRA. If an employer wants to design its QSEHRA to exclude some of the above-listed categories but not all of them, it is free to do so. For example, an employer might want to cover all employees without regard to age, or might want to cover employees immediately upon hire (i.e., without regard to the 90 day requirement).

Which employees cannot be covered under a QSEHRA?

A QSEHRA is not permitted to cover former employees (e.g., retirees) or owners of a business who are not considered to be employees.

May a QSEHRA provide different levels of benefits to different categories of employees?

Generally, a QSEHRA must be provided on the same terms to all eligible employees. However, the “same terms” requirement is not deemed to be violated if the maximum reimbursement under the QSEHRA varies from employee to employee based on the age of covered individuals or the number of individuals covered, in accordance with the variation in price of an insurance policy in the relevant individual health insurance market.

Which expenses can be properly reimbursed under a QSEHRA?

The expenses that can be reimbursed under a QSEHRA include (a) premiums for individual health insurance policies, and (b) other expenses that constitute medical care expenses under Section 213 of the Internal Revenue Code. However, medical expenses incurred before the employee became a participant in the QSEHRA cannot be reimbursed.

The insurance premiums that are reimbursed can include those for Medicare or Medicare supplement (Medigap) policies. Also, if the terms of the QSEHRA permit, premiums related to an employee’s family member can be reimbursed even if the policy covering the family member is not the same policy that covers the employee. Finally, a QSEHRA may reimburse premiums for coverage under a group health plan sponsored by the employer of the employee’s spouse. However, if the premium was paid on a pre-tax basis (as would normally be the case if the spouse’s employer maintains a cafeteria plan), the reimbursement for this premium from the QSEHRA is taxable to the employee (included as taxable income on the employee’s W2).

A QSEHRA need not be designed to cover all expenses that can be properly reimbursed under a QSEHRA. For example, in the interest of simplicity, a QSEHRA can be written to cover premiums for individual health insurance policies only.

Can a QSEHRA provide for carryover of unused reimbursements from one plan year to the next?

Yes, a QSEHRA can be designed (but is not required) to permit a carryover of unused reimbursement amounts from one plan year to the next, but the sum of the carryover amount and the amount regularly available in the next year cannot exceed the dollar limit for the next year. For example, a QSEHRA that imposes an annual limit of $2,000 can permit a carryover of any unused amount, such that an employee who does not have any reimbursements in year one would be eligible for $4,000 in reimbursements in year two. However, no carryover is permitted in a QSEHRA that provides for annual limits equal to the maximums permitted for each year, as such an arrangement would automatically violate the annual limits in year two.

Can a QSEHRA provide for cash-out of unused reimbursements?

No, amounts that are available under a QSEHRA but go unused by the employee (and are not carried over) are lost forever. The QSEHRA rules do not permit any cash-out of unused amounts.

What are the requirements for notices to employees?

Generally, an employer who provides a QSEHRA to its employees must provide a written notice describing the QSEHRA at least 90 days before the beginning of each plan year. However, there are a couple of exceptions. First, in the case of an employee who is not eligible to participate in the QSEHRA at the beginning of the year, the notice must be provided no later than the date on which the employee is first eligible to participate in the QSEHRA. Second, because complete guidance on the notice requirements was not issued by the IRS until October 2017 (via Notice 2017-67), the notice for a QSEHRA provided for 2017 and/or 2018 is deemed to be timely if provided not later than February 19, 2018.

The tax code imposes a penalty of $50 per employee (up to a maximum of $2,500 per year) on any employer that provides a QSEHRA but fails to provide the notice in a timely manner. Thus, employers should implement procedures ensuring that the notice is provided by the applicable deadline each year, and to all new employees who become eligible during the year, prior to eligibility.

The content of the written notice must include (a) a statement of the amount of each permitted benefit for which the employee might be eligible, (b) a statement that the employee must inform any Marketplace to which the employee applies for advance payments of the premium tax credit (PTC) of the amount of the permitted benefit, and (c) a statement that if the employee does not have minimum essential coverage (MEC) for any month, the employee may be liable for an individual shared responsibility payment for that month, and reimbursements under the QSEHRA for expenses incurred during that month will be included in the employee's taxable income. A model notice that can be used to satisfy the requirements is included as an appendix to Notice 2017-67.

What proof of coverage is required for a QSEHRA to make reimbursements?

A QSEHRA may provide for reimbursement only after the eligible employee provides proof that the employee (and the individual whose expense will be reimbursed, in the case of a family member) has minimum essential coverage (MEC) for the month in which the expense is incurred. The proof must consist of either (a) a document from a third party, such as the insurer, evidencing coverage (e.g., an insurance card or explanation of benefits) accompanied by an attestation by the employee that the coverage is MEC, or (b) 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. A model attestation that can be used to satisfy the requirements is included as an appendix to Notice 2017-67. Initial proof of MEC must be provided at least annually, and following the initial proof of coverage for a year, an attestation of ongoing MEC coverage must be provided with each request for reimbursement. Note: the employees of Pine River Library has submitted their proof of MEC coverage along with their election form and these are noted in the Demographics Notes/Remarks section.

How must claims for reimbursement under a QSEHRA be substantiated?

To ensure that a payment under a QSEHRA is for a proper expense, the claim for reimbursement must be "substantiated," using methods similar to those required with respect to flexible spending accounts (FSAs) under cafeteria plans. If a QSEHRA mistakenly reimburses an employee for an expense that has not been substantiated, all subsequent payments to all employees under the QSEHRA become taxable. However, the substantiation failure can be cured, and the tax-free nature of other payments under the QSEHRA can be preserved, provided that the employee either repays the unsubstantiated amount (with after-tax dollars) or provides the required substantiation not later than March 15 in the following year. All card transactions will require an itemized receipt. The card can be used for all eligible expenses except premiums which must be requested via a manual claim request.

What reporting must be done with respects to reimbursements under a QSEHRA?

Reimbursements under a QSEHRA are generally excluded from the employee's taxable income. However, the employee's permitted benefit is required to be reported on the employee's Form W-2. For this purpose, the "permitted benefit" is the amount the employee was entitled to receive under the QSEHRA, and not the reimbursements actually received. This amount is to be reported in box 12 of Form W-2 using code FF. Special rules apply when reimbursements under a QSEHRA are taxable, such as when premiums paid on a pre-tax basis for coverage under a group health plan maintained by the spouse's employer are reimbursed by the QSEHRA.

What happens if a QSEHRA is not operated in accordance with all of the rules?

If an arrangement fails to be a QSEHRA because one or more of the QSEHRA requirements are not satisfied, the arrangement constitutes a noncompliant group health plan subject to the ACA, with resulting excise taxes of $100 per affected person per day. Therefore, an employer should adopt a QSEHRA only if it is prepared to operate the QSEHRA in full compliance with all of the QSEHRA requirements.