Florida HEALTH INSURANCE ADVISORS

HRAs: Qualified Small Employer Health Reimbursement Arrangement (QSEHRA)

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A Qualified Small Employer Health Reimbursement Arrangement (QSEHRA) allows a small employer that does not have a group health plan to help its employees with the cost of *individual* health insurance. QSEHRAs are not the same as other forms of health reimbursement arrangements. They are permitted only for small employers that meet specific conditions. QSEHRAs can provide valuable tax benefits to the employer and employee, but they are complicated to design and administer.

QSEHRAs have been allowed since 2017 but have not gained much popularity. A new arrangement, called the Individual Coverage Health Reimbursement Arrangement (ICHRA), became available starting in 2020. ICHRAs offer more flexibility to employers of all sizes, which likely is making QSEHRAs even less attractive.

Background

Employers of all sizes generally are prohibited from making or offering any form of payment to employees for *individual* health insurance, whether through premium reimbursement or direct payment. Employers also are prohibited from providing cash or compensation to employees if the money is conditioned on the purchase of individual health insurance (some exceptions are allowed for dental- or vision-only plans or retiree-only plans).

The prohibition against employer-paid individual health insurance was implemented many years ago under the Affordable Care Act (ACA) to discourage employers from canceling their group plans and pushing workers into the individual insurance market. Employer violations could result in excise taxes of $100 per day per affected employee. This ACA rule was particularly disruptive for small businesses since many of them previously had subsidized the cost of individual policies instead of offering a group plan.

The 21st Century Cures Act, passed in 2016 with bipartisan support, provides relief to small employers in § 18001. It does not repeal the ACA’s general prohibition against employer payment of individual insurance premiums, but creates an exception for a special type of arrangement: the QSEHRA. The first QSEHRAs took effect January 1, 2017, allowing employers to reimburse their employees’ individual insurance premiums on a tax-free basis.

Conditions for QSEHRAs

Qualified Small Employer

To offer QSEHRAs, the employer must meet two conditions:

- Employs on average no more than 50 full-time and full-time-equivalent employees in the preceding calendar year. In other words, the employer cannot be an applicable large employer (ALE) as defined under the ACA; and
- Does not offer a group health plan to any of its employees. Any group health coverage, such as medical, dental, vision, and health flexible spending accounts, disqualifies the employer from offering QSEHRAs.

The above employer conditions apply to all employers in the same controlled group. For instance, if a parent company merely has a group vision care plan for a handful of employees, neither the parent company nor any of its subsidiary or sister companies is allowed to offer QSEHRAs.

QSEHRA

The QSEHRA must meet all of the following conditions:

- It must be offered to all full-time employees, although the employer may choose to extend eligibility to part-time employees. Retirees, former employees, and non-employee owners are not eligible.
- Seasonal employees, employees under age 25, new hires with less than 90 days of service, and/or union employees (if subject to bargaining) can be excluded even if they are full time.
- It pays or reimburses health care expenses incurred by the employee for himself or eligible family members. Health care expenses are defined in Internal Revenue Code § 213(d), including premiums for individual insurance, Medicare, or Medicare Supplement (Medigap). The employer may design its QSEHRA to limit the definition of eligible expenses.
- For tax-free QSEHRA benefits, the employee and any participating family members must have minimum essential coverage (MEC), such as through an individual policy, a spouse’s group plan, Medicare, or Medicaid. The employee must provide proof of MEC before the QSEHRA pays a benefit; e.g., copy of an insurance card or explanation of benefits (EOB) along with an attestation by the employee. For model attestation language, see Appendix B of Notice 2017-67.
- It does not pay or reimburse contributions for any employer-sponsored group coverage.
- The same benefits and terms apply to all eligible employees, except the benefit amount may vary by:
  - Single versus family coverage;
  - Prorated amounts for partial-year coverage (e.g., new hires); and
  - For premium reimbursements, variations consistent with the age- and family-size rating structure of a representative individual policy.
- Benefits do not exceed $5,300 if single coverage, or $10,700 if family coverage, per 12-month plan year (for 2021; for 2022, the amounts increase to $5,450 and $11,050, respectively). The amounts are prorated if covered for less than 12 months. The limits are indexed each year for inflation.

Exchange Subsidies

Coverage under a QSEHRA will affect the employee's eligibility for a subsidized individual policy from an insurance Exchange (Marketplace). If the QSEHRA constitutes affordable coverage, the employee is disqualified from receiving an Exchange subsidy. If the QSEHRA is not affordable coverage, the subsidy for which the employee qualifies is reduced dollar-for-dollar by the QSEHRA.

Employer Notices

Small employers offering QSEHRAs are required to provide a notice to each eligible employee that:

- Informs employees of the QSEHRA benefit amount;
- Instructs employees that they must give the QSEHRA information to the Exchange if they are applying for a subsidy for individual insurance; and
- Explains the tax consequences of failing to maintain minimum essential coverage.

QSEHRA notices must be provided at least 90 days before the start of the plan year. For new hires, the notice must be provided on or before the day the employee becomes eligible.

The IRS provides sample language for the notice in Q&A #38 of Notice 2017-67.

Form W-2 Reporting

Employers are required to report the total amount of the employee's permitted QSEHRA benefit on Form W-2, Box 12 using code FF. The reported amount is the total of payments and reimbursements that were available to the employee for that calendar year (excluding any carryover amounts from prior years), regardless of whether the employee actually received the amount.

Although employers that file fewer than 250 Forms W-2 are exempt from other reporting requirements, the exemption does not apply to QSEHRA reporting.

Other Federal Provisions

QSEHRAs are subject to ERISA's reporting and disclosure rules, so plan documents and summary plan descriptions (SPDs) are required. Form 5500 generally is not required due to the "small plan exception."

The annual Patient-Centered Outcomes Research Institute (PCORI) fee applies.

QSEHRAs are exempt from the following requirements:

- Summary of benefits and coverage (SBC);
- COBRA continuation coverage; and
- ACA reporting (e.g., Form 1095-B).

State Laws

Some states restrict employers from “involvement” in the purchase of individual insurance if employer funding is provided. It is unlikely such laws apply to employers offering QSEHRAs, but employers are advised to review the laws of the states in which their employees are located before implementing QSEHRAs.

More Information

Employers that are considering QSEHRAs are encouraged to work with legal counsel and tax advisors that offer expertise in this area. The rules are complex, and employers must ensure the QSEHRAs are designed, communicated, and administered correctly in order to avoid adverse tax consequences for the employer and employee. The IRS provides valuable guidance in Notice 2017-67.

A new type arrangement called the Individual Coverage Health Reimbursement Arrangement (ICHRA) became available starting in 2020. The rules for QSEHRAs did not change, but ICHRAs may be a better option since this new arrangement is allowed for both small and large employers even if the employer offers a group plan to some of its workers.