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GRIST**IRS OUTLINES HOW INDIVIDUAL-COVERAGE HRAS CAN MEET ACA EMPLOYER MANDATE**

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Starting in 2020, individual-coverage and excepted-benefit health reimbursement arrangements (HRAs) meeting certain conditions can play a role in an employer's healthcare strategy. Recently proposed [IRS rules](#) offer insight into how these new types of HRAs — particularly individual-coverage HRAs — interact with employer shared-responsibility (ESR) requirements under the Affordable Care Act (ACA) and the nondiscrimination rules for group health plans under Section 105(h) of the Internal Revenue Code. This GRIST discusses the proposed rules, which employers can follow until IRS issues final regulations. Comments on the proposed rules are due by Dec. 30.

SCOPE OF PROPOSED REGULATIONS

The proposed rules build on [final triagency regulations](#) released in June outlining new types of individual-coverage and excepted-benefit HRAs and how to integrate these account-based group health plans with individual insurance or Medicare. While the new IRS guidance is complex, some employers that may want to consider offering individual-coverage HRAs include:

- Small employers exempt from the ESR rules — specifically, those with less than 50 full-time or full-time equivalent employees
- Larger employers with groups of employees not covered by the ESR rules — like part-time employees or variable-hour employees during a nonassessment period (e.g., under the lookback method)
- Larger employers that prefer not to offer traditional group health plan coverage to certain cohorts of full-time employees and are prepared to handle the individualized ACA affordability calculations and ACA reporting for individual-coverage HRAs, among other issues

The proposed IRS rules provide guidance on how existing ESR and nondiscrimination requirements apply to individual-coverage HRAs. Until IRS issues final regulations, employers interested in offering individual-coverage HRAs may rely on the proposed rules.

ESR Requirements

Employers with at least 50 full-time or full-time equivalent employees must offer nearly all of them adequate health coverage or risk paying one of two ACA assessments under Code Section 4980H:

- **4980H(a) assessment.** This assessment applies to employers that don't offer minimum essential coverage (MEC) to at least 95% of their full-time employees (and their dependent children) if at least one full-timer receives a premium tax credit for coverage on a public exchange. The annually adjusted assessment can be very steep since it is multiplied by the employer's total number of full-time employees — not just the employee(s) who received the premium tax credit. The 4980H(a) assessment is \$2,500 for 2019 and will increase to \$2,570 for 2020.
- **4980H(b) assessment.** The second assessment applies to employers that either don't offer coverage to some full-time employees (and their dependent children) or offer coverage that is either unaffordable to them and/or doesn't meet the ACA's minimum value standards. Calculation of this annually adjusted assessment is based only on the number of persons who actually received a premium tax credit. The 4980H(b) assessment is \$3,750 for 2019 and will increase to \$3,860 for 2020.

IRS actively enforces and collects both assessments from employers. To help IRS track ACA compliance, employers must annually report on the MEC offered or provided to employees and their dependents, including information on the affordability of that coverage.

As discussed below, individual-coverage — but not excepted-benefit — HRAs count as an offer of MEC that can help employers avoid the 4980H(a) assessment. Whether offering individual-coverage HRAs can help avoid the 4980H(b) assessment depends on complex affordability determinations, but the proposed IRS rules provide certain safe harbors to simplify those calculations.

Section 105(h) Nondiscrimination Requirements

Section 105(h) sets out a number of nondiscrimination requirements that apply to self-insured medical reimbursement plans, including HRAs. If a self-insured plan's eligibility terms or benefits discriminate in favor of highly compensated individuals (HCIs), they must be taxed on excess reimbursements. A plan can't satisfy this nondiscriminatory benefits rule unless:

- All other participants receive all benefits provided to HCIs.
- The employer contribution is uniform for all participants and dependents and does not vary based on age or service.
- If the plan has HCIs, it cannot base the type or amount of benefits reimbursed on compensation.

The proposed IRS rules provide safe harbors for applying these nondiscrimination requirements to HRAs.

MEC AND AFFORDABILITY RULES FOR INDIVIDUAL-COVERAGE HRAS

While excepted-benefit HRAs do not count as MEC for ESR purposes, the proposed rules confirm earlier guidance ([IRS Notice 2018-88](#)) that individual-coverage HRAs are considered MEC. Thus, an employer could offer an individual-coverage HRA to some or all of its full-time employees as part of an overall strategy to avoid paying the 4980H(a) assessment.

For an employer to avoid the 4980(b) assessment, an individual-coverage HRA must be affordable. The proposed rules add a new affordability test just for individual-coverage HRAs. Unlike the ESR affordability rules for traditional group coverage, the proposed rules for individual-coverage HRAs generally require employers to determine affordability on an employee-by-employee basis. However, IRS has proposed a number of safe harbors to simplify these determinations for individual-coverage HRAs. The proposed safe harbors for individual-coverage HRAs supplement the three current safe harbors that employers can use for determining whether MEC is affordable for an employee. An individual-coverage HRA that is affordable automatically qualifies as minimum-value coverage under Section 4980H(b).

ESR Affordability Rules and General Safe Harbors

Affordability for ESR purposes is based on an employee's required contribution for coverage relative to a certain percentage of his or her household income. To calculate an employee's required contribution:

- **Step 1.** Identify the monthly premium that someone who is the employee's age must pay self-only coverage under the lowest-cost silver plan on the public exchange where the employee's residence (or primary worksite under a safe harbor) is located.
 - The Centers for Medicare & Medicaid Services (CMS) has a [tool](#) that can help employers identify the lowest-cost silver plan for different age groups. Although this tool only covers states using the federal [Healthcare.gov](#) platform, CMS is working to find a way to include data for other states.
- **Step 2.** Determine the difference between the employer's monthly HRA contribution and the monthly silver plan premium identified in Step 1. The result is the employee's required contribution.

If the employee's required contribution is less than an annually adjusted percentage — 9.86% in 2019 and 9.78% in 2020 — of the employee's household income, the coverage is considered affordable for ESR purposes.

Because employers usually do not know an employee's household income, they can use one of three long-standing [safe harbors](#) — the employee's W-2 wages, rate of pay or [the federal poverty line](#) (FPL) — rather than household income in this calculation. Use of any particular safe harbor is optional, but any safe harbors used must be applied uniformly and consistently within a class. (These safe harbors don't apply when determining whether someone is eligible for the premium tax credit.)

Example. Hometown Co. has 55 full-time employees in a single location. The company offers all employees an individual-coverage HRA funded with \$6,000 (\$500 per month) for 2020. The lowest-cost silver plan for Naomi, one of the employees, is \$600 per month. Naomi's required

contribution is \$100 per month, which is the difference between the lowest-cost silver plan for her and the amount her employer contributes to the HRA.

Under the FPL safe harbor for 2020, the monthly affordability limit is \$101.79 (9.78% of \$12,490 divided by 12). Because Naomi's required monthly contribution (\$100) does not exceed \$101.79, the individual-coverage HRA provides affordable coverage for her. Hometown Co. will not owe any assessment for Naomi if she receives a premium tax credit for public exchange coverage.

Naomi's co-worker, Owen, is older than her, and the lowest-cost silver plan for him is \$700 per month. So Owen's required contribution is \$200 per month — the difference between the lowest-cost silver plan for him and the amount his employer contributes to the HRA.

The individual-coverage HRA does not provide affordable coverage for Owen because his \$200 required monthly contribution exceeds \$101.79, the FPL safe harbor limit. If Owen opts out of the individual-coverage HRA for 2020 and receives subsidized coverage on a public exchange, Hometown Co. will owe an annual 4980H(b) assessment of \$3,860 for Owen.

Primary Worksite Safe Harbor for Individual-Coverage HRAs

For premium tax credit purposes, whether an individual-coverage HRA is affordable for an employee depends partly on the monthly premium for self-only coverage under the lowest-cost silver plan on the public exchange where the employee *resides*. Because tracking those premiums for each employee might prove difficult for employers, the proposed rules provide a safe harbor: An employer may instead use the monthly premium for self-only coverage for the lowest-cost silver plan on the public exchange where the employee's *primary site of employment* is located.

Determining the primary site. The proposal defines an employee's primary site of employment as the location where the employer reasonably expects the employee to perform services on the first day of the plan year or, if later, on the first day the employee becomes eligible for the HRA. If an employee regularly works remotely but has an assigned office space, the assigned office space is the primary work site. If a remote employee doesn't have an assigned office space, the primary work site is the employee's residence.

Change in primary site during the plan year. An employer relying on this safe harbor may need to reassess affordability if an employee's primary work site changes, and the employer expects that change to be permanent or indefinite. Affordability determinations must take the new work site into consideration by the first day of the second calendar month after the employee has begun working at the new location. If a work-site change occurs in the first year the HRA is offered, affordability determinations must reflect the change by the later of these dates:

- First day of the plan year
- First day of the second calendar month after the employee starts at the new location

Multiple work sites within a rating area. In some rating areas, the lowest cost-silver plan varies in different locations — for example, by county or zip code. As a result, an employer with multiple worksites within the same rating area will need to determine affordability using the lowest-cost silver plan where the employee’s particular worksite (or residence, if applicable) is located. However, employers can’t modify their contributions within a rating area to take into account the differences in premiums. This is because the integration rules for individual-coverage HRAs don’t allow employers to have a class of employees smaller than the rating area. One solution might be for employers to use the most expensive of the lowest-cost silver plans in the entire rating area to set the uniform employer HRA contribution and determine affordability in that area.

Age-Related Safe Harbor for Individual-Coverage HRAs

Affordability determinations for premium tax credit purposes will vary based on each employee’s age. The proposal provides a safe harbor for individual-coverage HRAs that allows the employer to determine affordability using an employee’s age on the first day of the plan year. For an employee who becomes eligible for an individual-coverage HRA during the plan year, the employer can use the employee’s age on the date that the HRA is first effective. Employers also can use the lowest-cost silver plan for the youngest age band in the individual market for the employee’s applicable location.

Lookback-Month Safe Harbor for Individual-Coverage HRAs

Employers typically determine health benefits for the coming plan year long before the fall release of exchange premium rates. The proposed rules include a lookback-month safe harbor to make affordability determinations for each employee:

- An employer with a calendar-year individual-coverage HRA may use the monthly self-only premium for the lowest-cost silver plan in January of the prior calendar year.
- An employer with a noncalendar-year individual-coverage HRA may use the monthly self-only premium for the lowest-cost silver plan in January of the current calendar year.

This safe harbor allows employers to use the self-only premium for the lowest-cost silver plan in the lookback month to make affordability determination for each month of the current plan year. However, employers still must assess affordability using an employee’s age for the current plan year (or the youngest age band for the lowest-cost silver plan) and applicable location for each month.

ACA REPORTING FOR INDIVIDUAL-COVERAGE HRAS

For employers subject to ESR requirements, offering an individual-coverage HRA — but not an excepted-benefit HRA — counts as an offer of MEC for ESR reporting purposes. Employers with individual-coverage HRAs must also report each employee’s required contribution along with other information. Employers presumably will report this detail in Line 15 of IRS [Form 1095-C](#) — or an amended Line 15 that includes changes for reporting individual-coverage HRAs. IRS and Treasury are still considering whether and how to revise the codes used in Form 1095-C reporting to account for individual-coverage HRAs. The proposed regulation states that additional guidance will set out how to report individual-coverage HRAs to satisfy the ESR requirements and demonstrate compliance with Section 4980H(b).

Because individual-coverage HRAs are group health plans that provide MEC, employers presumably must report this MEC for each person enrolled in the HRA, but IRS will need to provide direction on how to do so. Employers subject to the ESR requirements may need to report MEC offered through individual-coverage HRAs by completing Part III of the Form 1095-C. Employers not subject to the ESR requirements may need to report individual-coverage HRAs as MEC by completing IRS [Form 1095-B](#). However, because Congress reduced ACA's individual-mandate penalty to zero, IRS and Treasury are studying whether to change MEC reporting for future years and, if so, what changes to make.

NONDISCRIMINATION RULES FOR INDIVIDUAL-COVERAGE HRAS

The proposed rules clarify when and how the Section 105(h) nondiscrimination rules apply to individual-coverage HRAs.

Premium-Reimbursement HRAs Exempt From 105(h) Nondiscrimination Rules

The proposed rules confirm that self-insured plans — like individual-coverage HRAs — that only reimburse employees' premiums paid for health insurance are treated like insured plans, which are exempt from the 105(h) nondiscrimination rules. Premium-reimbursement-only group health plans may become subject to ACA's Section 2716 nondiscrimination rules for insured plans, but those rules — which are supposed to be similar to the 105(h) rules — are [currently on hold](#).

A plan that reimburses not just health insurance premiums but other medical expenses (as defined in [Section 213\(d\)](#)) remains subject to the 105(h) nondiscrimination rules.

Variations in Employer HRA Contributions by Class, Age Permitted

Under the final integration rules, employers may offer individual-coverage HRAs to specific classes of employees and vary HRA terms, conditions and contributions among the different classes. Within classes, employers can vary contributions based on age, but all participants of the same age must receive the same contribution. In addition, the maximum contribution cannot exceed three times the contribution made for the youngest participant within a class.

The proposed rules include a nondiscrimination safe harbor for individual-coverage HRAs that permits employers to vary contributions as allowed by the integration rules. But an individual-coverage HRA could still be discriminatory in operation under existing rules if a disproportionate number of HCIs receive the maximum employer HRA contribution based on their ages.

CAFETERIA PLAN ISSUES

Under [Section 125\(f\)\(3\)](#), an employer generally can't offer a qualified health plan on a public exchange as a cafeteria plan benefit. Therefore, an employer can't allow employees to make pretax salary reductions through a cafeteria plan to pay for individual coverage offered on a public exchange.

Nonetheless, an employer may allow employees to make pretax salary reductions through a cafeteria plan to pay for individual health coverage outside of a public exchange. The preamble to the proposed rules confirms this point, but IRS has requested comments on where the 125 rules for arrangements like individual-coverage HRAs may need clarification or modification to reduce compliance burdens.

EMPLOYER CONSIDERATIONS

Employers may want to provide comments on the proposed rules to IRS and Treasury by Dec. 30, 2019. Until final rules are issued, employers can rely on the proposed rules to design individual-coverage HRAs for 2020. Employers interested in offering individual-coverage HRAs should review a number of considerations, including these questions:

- ***Will ESR requirements apply for employees offered individual-coverage HRAs?*** Smaller employers exempt from ESR requirements and larger employers offering these HRAs to part-time employees won't need to make affordability determinations. However, even these employers may need to comply with MEC reporting requirements.
- ***How will individual-coverage HRAs affect the employer's overall ESR strategy?*** Individual-coverage HRAs can satisfy 4980H(a) requirements for offering MEC, but the employer could still face 4980H(b) assessments if the individual-coverage HRA is not affordable for one or more employees, who then receive subsidized public exchange coverage. If most employees have incomes exceeding 400% of the FPL (\$85,320 for a family of three in 2020), the employer's risk for ESR assessments won't be large since employees can't receive an exchange subsidy, regardless of whether the HRA is affordable. In addition, employees using their HRAs to help pay premiums for Medicare or insurance not from a public exchange can't receive the premium tax credits that trigger an ESR assessment.
- ***How will individual-coverage HRAs affect employees' eligibility to receive premium tax credits for exchange coverage?*** Offering an affordable individual-coverage HRA could make an employee ineligible for a premium tax credit when using the HRA to buy exchange coverage. While the HRA dollars will help employees purchase individual health insurance, the lost premium tax credit for some employees might far exceed the funds provided by the employer's HRA. These lost dollars could be significant for employees with families, since ACA affordability determinations use the cost of self-only coverage — not the actual cost to insure a family. Employers should weigh this issue when considering HRAs for both full-time and part-time employees and deciding what contribution to make available each month.
- ***Is the employer prepared for the potential complexities of administering individual-coverage HRAs?*** Larger employers subject to ESR requirements should keep ACA affordability and reporting requirements in mind when considering individual-coverage HRAs. In some cases, the administrative complexity could outweigh any benefit from offering these HRAs. Here are two approaches that employers might take and how the new rules would apply:
 - *Individual-coverage HRAs with a uniform flat-dollar contribution for every employee in the same class (e.g., \$5,000 per employee).* Employers using this design would likely face complex (and individualized) affordability determinations. This is because the flat-dollar employer contribution could make the individual-coverage HRA affordable for some younger employees but unaffordable for some older employees. To simplify matters, employers could use the age of the oldest employee in setting their contribution in order to meet affordability determinations. However, that

strategy would likely prove expensive and could eliminate any expected cost savings from offering individual-coverage HRAs.

- *Individual-coverage HRAs with employer contributions that vary by class and age.* Under this approach, an employer would need to perform individualized affordability calculations and report MEC information on each employee's IRS Form 1095-C. This could become difficult for all but very small groups of employees. An employer might vary contributions by age and class so the HRA is always or never affordable for different groups, which might simplify reporting. But doing so could be a complex task for a large group of employees that has frequent turnover.
- **How will nondiscrimination rules apply to individual-coverage HRAs?** If the HRAs will reimburse only premiums, the nondiscrimination rules won't apply. But if the HRAs reimburse medical expenses in addition to (or instead of) premiums, the nondiscrimination rules will apply. In this scenario, employers still can use the HRA safe harbors to vary contributions, as the integration rules allow.
- **What impact will individual-coverage HRAs have on the employer's bottom line and overall healthcare strategy?** Employers need to consider whether offering individual-coverage HRAs would save money in the overall benefits budget, in light of administrative complexities. Employers should also review whether offering individual-coverage HRAs might cause any employees to drop coverage altogether. Finally, if replacing group coverage with individual-coverage HRAs, the employer will want to determine the potential effect on recruiting and retention in a competitive job market.

RELATED RESOURCES

Non-Mercer Resources

- [Proposed IRS Rules on Application of ESR and Nondiscrimination Rules to HRAs Integrated With Individual Coverage or Medicare](#) (Federal Register, Sept. 30, 2019)
- [How HRAs Help Employers Expand Coverage Options for Their Employees](#) (CMS, Sept. 27, 2019)
- [Individual-Coverage HRA Employer Look-Up Table for Lowest-Cost Silver Plan Premium](#) (CMS, Sept. 26, 2019)
- [Dictionary for Individual-Coverage HRA Employer Look-Up Table for Lowest-Cost Silver Plan Premium](#) (CMS, Sept. 26, 2019)
- [Rev. Proc. 2019-29](#) (IRS, June 22, 2019)
- [Final Rules on HRAs and Other Account-Based Group Health Plans](#) (Federal Register, June 20, 2019)
- [FAQs on Individual-Coverage and Excepted-Benefit HRAs](#) (Department of Labor (DOL), June 13, 2019)
- Model Individual-Coverage HRA Notice in [Word](#) and [PDF](#) Formats (DOL, June 13, 2019)

- Model Individual-Coverage HRA Attestations in [Word](#) and [PDF](#) Formats (DOL, June 13, 2019)
- [Press Release on Revised HRA Rules](#) (DOL, Department of Health and Human Services, and IRS, June 13, 2019)
- [Notice 2018-88](#) (IRS, Nov. 19, 2018)
- [Executive Order 13813](#), Promoting Healthcare Choice and Competition Across the United States (White House, Oct. 12, 2017)

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- [2020 Affordable Percentage for Employer Health Coverage Shrinks](#) (July 23, 2019)
- [Final Rules Ease Restrictions on Health Reimbursement Arrangements](#) (June 14, 2019)

Other Mercer Resources

- [Administration Proposes Major Expansion of Health Reimbursement Accounts](#) (Oct. 25, 2018)
- [What If Employees Could Buy Coverage With Tax-Free HRA Contributions?](#) (Oct. 12, 2017)

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