

RE: Affordable Care Act & Health Reimbursement Arrangements

Dear Business Owner,

The IRS has issued guidance indicating that health reimbursement arrangements (HRAs) that do not comply with the Affordable Care Act (ACA) are subject to severe penalties.

An HRA is an arrangement whereby the employer reimburses the employee for part or all of qualified medical care expenses and provides coverage up to a maximum dollar amount for the period covered.

Generally, small employers are not required to provide health insurance to their employees. However, many small employers provide cash reimbursement for employees who purchase an individual policy. Under prior law, reimbursements for the employee's share of medical insurance premiums were treated as contributions by the employer to the health plan and, thus, deductible by the employer and excluded from wages by the employee. Recent guidance indicates that beginning in 2014, employers with two or more employees may be subject to severe penalties were they to use such an arrangement.

Under the current guidance, an HRA that covers two or more employees is deemed a group health plan and is subject to ACA requirements which include, among other things, a prohibition on annual and lifetime limits, and a prohibition on cost-sharing for preventive services.

Although there are limited exceptions, IRS guidance makes clear that HRAs, HSAs, and most other pre-tax arrangements that reimburse insurance premiums are nonqualifying. These arrangements are deemed nonqualifying whether or not the coverage purchased by the employee complies with the ACA rules. Nonqualifying arrangements are subject to penalties as high as \$100 per day, per individual. The penalty is an excise tax that is required to be self-reported on Form 8928. In many circumstances a waiver of the tax may be permitted and no tax will be due upon filing.

Beginning January 1, 2014, for an employer to be able to provide a deductible health insurance fringe benefit to an employee, the health plan must be sponsored and paid for by the employer on a non-discriminatory basis. The employee may pay a portion of the coverage through a pre-tax flexible spending account (FSA), or absent FSA participation, on a post-tax basis.

Thus, an employer has the following options:

1. Offer an employer-sponsored plan,
2. Offer nothing, or
3. Offer nothing and increase taxable (perhaps, even gross-up) wages

In the absence of further guidance from the Department of Labor or Treasury, entities with two or more employees should avoid reimbursement of health care premiums outside of an employer-provided group health care plan.

Employers with compliance questions or those who utilized an HRA in 2014 are encouraged to consult with their payroll advisor or plan administrator regarding corrective measures. Also, we will need to be notified of non-compliance with the ACA in order to accurately complete Form 8928 and, if applicable, apply the waiver.

Regards,

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