A New Health Care Option for Small Employers – Qualified Small Employer Health Reimbursement Arrangements

Of interest to employers with fewer than 50 full-time equivalent employees

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Tucked at the end of the recently enacted 21st Century Cures Act is a provision that offers certain small employers a new opportunity to help employees purchase individual market major medical coverage and pay for other medical expenses on a tax-free basis. The new arrangements, called Qualified Small Employer Health Reimbursement Arrangements (QSEHRAs), are likely to be attractive to many qualifying small employers, but there are some features that should be looked at carefully before deciding to move forward.

The following FAQs provide useful information regarding QSEHRAs.

1. Why are QSEHRAs important?

The new law allows small employers to provide employees with maximum flexibility and health coverage cost-savings on a pre-tax basis. Employer funds contributed to a QSEHRA are excluded from the employee’s taxable income and payroll taxes and can then be used to pay or reimburse employees for premiums on their own individual major medical insurance coverage, Medicare supplemental insurance (for small employers, e.g., with fewer than 20 employees, exempt from the Medicare secondary requirements), or other unreimbursed medical expenses on a pre-tax basis.

The new law provides savings for employers. Employer funds contributed to a QSEHRA are not subject to payroll (FICA, FUTA, and Medicare) taxes.

The new law protects employers from hefty IRS penalties: Previously, the fine was $100 per day, per employee if employers tried to make health insurance more affordable by directly paying or reimbursing their employees for premiums for individual market major medical insurance or medical expenses.

2. Which employers are eligible to have a QSEHRA?

Employers must meet both of the following two requirements in order to have a QSEHRA:

(1) The employer must be a small employer. For QSEHRA purposes, a small employer is an employer that had less than 50 full-time equivalent employees in the prior calendar year. If the employer is part of a related group of companies, the employees of all the related companies are counted in determining if the employer is a small employer.
(2) The employer cannot offer a group health plan to any employee. QSEHRAs are limited to employers that do not otherwise offer a group health plan. Thus, for example, an employer cannot offer coverage under a group major medical plan to some employees and offer a QSEHRA to others.

3. Who can contribute to a QSEHRA and how much can be contributed?

Only employer contributions are permitted. Employees cannot contribute to a QSEHRA. Contributions cannot be deducted from employees’ pay.

The maximum allowed contribution for a year is:

- $4,950 if only the employee is covered, and
- $10,000 if the arrangement covers family members of the employee.

These dollar amounts are prorated if an employee is covered under the QSEHRA for less than a full year. For example, if an employee and his or her spouse are covered under a QSEHRA for 6 months of a year, the maximum permitted contribution for that employee for the year would be $5,000. The dollar amounts will be indexed for inflation in the future.

4. Does the employer have to make contributions for all employees?

In general, yes, the employer must make a contribution for all employees. However, the following employees can be excluded:

- Employees who have not completed 90 days of service;
- Employees who have not attained age 25;
- Part-time or seasonal employees;
- Employees covered by a collective bargaining agreement; and
- Nonresident aliens who receive no earned income from the employer from sources within the United States.

Note that the definition of “part-time” and “seasonal” employees is not the same that is used for purposes of determining if the employer is a small employer.

5. Does the employer have to make the same contribution for each employee?

In general, yes; however, variations in contributions are permitted:

- Based on the age of the employee (and the age of family members if they are covered), and
- Based on the number of family members covered.

The amount of permitted variation in contributions is determined by reference to an individual market major medical policy in the relevant area. The same reference individual market policy must be used for all employees.
6. Does COBRA apply to QSEHRAs?

No.

7. What medical expenses can be paid for or reimbursed through the QSEHRA?

Reimbursements that are permitted under a QSEHRA are expenses for medical care as defined under the federal tax laws. This definition includes items such as premiums for individual market major medical coverage, dental coverage, and vision coverage, and out of pocket expenses, such as copayments or deductibles that have not been reimbursed from another source. Premiums paid by the employee on a pre-tax basis for coverage under a group health plan of another employer (e.g., the spouse’s employer) do not qualify for tax-free treatment.

8. What do employees need to know about QSEHRAS?

There are three main things employees need to be aware of.

First, in order to get tax-free treatment the employee must have what is called “minimum essential coverage” or MEC. This is the type of coverage that satisfies the individual mandate requirement under health care reform. QSEHRAs are not MEC, so the employee will need to have other coverage, such as individual major medical coverage (which can be paid for through the QSEHRA), coverage through another employer’s plan, or Medicare. If the employee does not have MEC, then payments or reimbursements from the QSEHRA are included in the employee’s income, even if the payment is for a medical expense.

Second, in order to receive a payment from a QSEHRA, the employee will need to provide substantiation of the medical expense. For example, a receipt from a health care provider for an expense not covered by insurance or proof of premiums paid by the employee for individual market insurance.

Third, for employees who purchase individual major medical coverage through a federal or state Marketplace, eligibility for and the amount of any premium tax subsidy available may be impacted if the employee is eligible for a QSEHRA.

9. What other requirements apply to employers that adopt a QSEHRA?

Employers are required to notify eligible employees of a QSEHRA 90 days before the beginning of the year in which the employer will fund the arrangement. A special rule applies for 2017 which allows the notice to be provided prior to April 1st for QSEHRAs adopted before that date. The notice must include the amount of the benefit under the QSEHRA and also inform the employee that payments may be taxable if the employee does not have MEC. Employers must also report the permitted benefit on the employee’s Form W-2 for the year (even though it is not taxable).

Employers will also need to adopt a simple health reimbursement arrangement that is compliant with the QSEHRA provisions. In addition, the employer (or its TPA) must have procedures to substantiate the medical expenses that are reimbursed under the QSEHRA.
Note that for insurers, brokers and agents, some states consider individual health insurance paid for by employers to be group health insurance. Thus, insurers, brokers and agents working with small employers should carefully consider state-law implications. Some states have already started to review and change these rules in light of the law, although it may take some time.

10. When can employers adopt a QSEHRA?

The QSEHRA provisions became effective on January 1, 2017. This means that employers may adopt QSEHRAs now; however some planning is involved so it may take a while to make decisions and get a plan up and running.

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