

21st Century Cures Act Qualified Small Employer Health Reimbursement Arrangements (“QSEHRAs”) May Not Be the Total Cure

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QSEHRAs are designed for employers that are not applicable large employers under the employer shared responsibility tax (Code section 4980H). *QSEHRAs may only be offered by employers with fewer than 50 full-time employees (as defined in Code section 4980H (working 30 or more hours per week with a variety of ways to determine such hours)). Employers desiring to use a QSEHRA will need to first determine the members of their controlled group (entities or businesses under common ownership or control) as their eligibility depends upon the number of full-time employees of the controlled group members and whether any of such members offer a group health plan.* Employers desiring to use QSEHRAs need to verify that no one in their controlled group offers a health plan because any member offering a health plan will taint the eligibility of the entire group.

QSEHRAs are Not the Same as Historical HRAs

Employers desiring to offer a QSEHRA must be aware that these arrangements are different in many significant respects from the health reimbursement arrangements first recognized under IRS Notice 2002-45 (“HRA”) and QSEHRAs also carry many additional requirements, such as the requirement that the individual must certify that they have MEC before each expense is reimbursed in order for the expense to be eligible and excluded from the individual’s income and to not disqualify the QSEHRA. Disqualifying a QSEHRA means loss of the income tax exclusion for the individual, and depending upon the violation it may mean loss of being exempt from the group health plan definition and would trigger application of all provisions applicable to group health plans under the Code, COBRA, the ACA requirements (including the requirement that HRAs be integrated with a group health plan) and under the Medicare secondary payer statute.

Non-discrimination or “Same Terms” Requirement for QSEHRAs

While the health reimbursement arrangements under IRS Notice 2002-45 had to meet the non-discrimination requirements of Code section 105(h), QSEHRAs must meet the “same terms” requirement which adds a new set of requirements designed to prevent the offering of discriminatory benefits. *QSEHRAs must meet the making the reimbursement level available on the “same terms” requirements described in IRS Notice 2017-67 and such requirements will require careful planning.* Careful attention must be paid to the guidance on what constitutes “same terms” as some of these requirements are not intuitive.

QSEHRAs, while they can be designed to carryover unused amounts from the prior year, are subject to the dollar limitation on the benefit in total so carryovers do not provide an additional benefit as they did under the original version of a HRA and adding a carryover to a design will require careful planning to ensure that the “same terms” requirement is satisfied. QSEHRAs limits are set by the family size and age on the first day of the plan year and it is not required to be adjusted for changes in family size, so the limit is not adjusted for marriage, birth or adoption during the year. A QSEHRA may by its terms provide for adjustments midyear for family composition changes, but it is not required to do so and if it does make such adjustments, then it must also adjust the amounts it reports on the respective employee’s Forms W-2 for the calendar year of the change.

Other Health Plan Laws

QSEHRAs by definition under the statute are not group health plans and thus are exempted from being a group health plan for purposes of COBRA, the Medicare Secondary payer tax under Code section 5000 (While there was no amendment to the Medicare secondary payer statute and its separate sanctions such statute borrows the group health plan definition from the Code so presumably QSEHRAs will also be exempt from Medicare secondary payer as long as the QSEHRA is compliant.) and the Affordable Care Act, provided they qualify. QSEHRAs are not exempted from being a group health plan for purposes of HIPAA privacy and security requirements.

Fair Labor Standards Act Considerations

Employers desiring to adopt a QSEHRA should not only consider the tax law requirements under the statute and IRS Notice 2017-67, but must also consider applicable employment law implications in adopting such arrangements following *Flores v. City of San Gabriel*, 824 F.3d 890, cert. den'd 137 S. Ct. 2117 (2017) which found that an opt-out payment under what tax types call a flexible benefit plan or cafeteria plan had to be treated as part of the employee's "regular rate of pay" under the Fair Labor Standards Act of 1938 because while the tax bar would think it was paid under a plan, the flexible benefit plan in this situation did not meet the Fair Labor Standards Act definition of a "bona fide benefit plan." *The statute creating QSEHRAs did not make any conforming changes to the Fair Labor Standards Act and employers considering QSEHRAs may want to consider consulting labor and employment counsel to try to mitigate any risk of a collective action for recalculation of over-time pay from non-exempt employees. Just because something is a plan for the Internal Revenue Code or ERISA purposes, does not necessarily make it a "bona fide plan" for Fair Labor Standards Act purposes.*

Notice Requirements

QSEHRAs require a notice to be provided to participants in advance of their participation in the QSEHRA benefit. The notice must include specified content. The notice also must be modified for mid-plan year entries and the proration of the limit and benefit for such individuals. *Employers will need to be careful to ensure that the notices they use incorporate all of the required elements and that each mid-year notice also meets the requirements so the individual knows or can calculate their potential benefit.*

Substantiation of Expense Required

All expenses reimbursed by a QSEHRA must be substantiated to demonstrate that the expense was paid for a medical expense recognized as such under the Code and IRS guidance. The substantiation required is the same type of substantiation required for health expenses in other employer sponsored health plans. *If a QSEHRA erroneously pays an expense that is not properly substantiated, the entire QSEHRA fails to qualify and all reimbursements from the QSEHRA become taxable to the employees.* Mistaken individual payments can be corrected by timely submission of substantiation or by repayment with after tax dollars if the "timeliness" requirements specified in the Notice are satisfied.

Mishap Corrections

The Notice includes different sanctions for different levels of a QSEHRA's failure to satisfy different requirements in the Notice. Some violations will cause loss of the QSEHRA's exemption from being a group health plan and such a violation will trigger sanctions under a variety of laws as opposed to mere loss of the preferential tax treatment of benefit payments for individuals. Any issue must be carefully reviewed in light of the Notice's various sanctions.

In an interesting twist, a QSEHRA may reimburse an *over the counter medical* expense that is *not prescribed*, but it will be treated as income to the recipient (so the QSEHRA needs to track such reimbursements). Such taxable reimbursements are required to be reported on the individual's Form W-2. *If there is a prescription for the over the counter medical expense, it is not taxable to the individual.*

Plan Document and Operating Policies and Procedures Needed

Any QSEHRA that was drafted before this guidance was released should be carefully reviewed to determine how it may need to be changed for 2018. The Notice provided limited relief for document issues that currently exist, provided the QSEHRA was established before the Notice was issued and it was drafted to be in good faith compliance. A QSEHRA should be reviewed for its compliance with this expanded explanation of the requirements for a QSEHRA. A QSEHRA's operating procedures, reporting procedures and records should also be reviewed for compliance.

Reporting Requirements

Employers sponsoring QSEHRAs will need to report the QSEHRA benefit available to each employee on the employee's Form W-2 and this permitted benefit must be the amount newly available to each individual in the calendar year. So this amount will vary by the length of time the individual participates in the QSEHRA and by the number of persons covered and other factors. Employers must also report taxable reimbursements (e.g., the QSEHRA reimburses a medical expense in a month in which the individual did not have MEC, then the reimbursement is income in box 1 as wages, but are not included in box 3 for Social Security and FUTA wages or box 5 for Medicare wages and those reimbursements are not subject to federal income tax withholding requirements. There are also codes to be included for reporting. Nothing is ever simple. Notice 2017-67 includes more reporting and withholding questions and answers for special situations.

A QSEHRA that complies with the Notice's requirements is not required to be reported as group health plan coverage provided to an individual on a Form 1095-B. The Notice included detailed descriptions of how a QSEHRA benefit interrelates with the Premium Tax Credit and the Advance Premium Tax Credit which are beyond the scope of this alert, but which need to be considered in establishing a QSEHRA. There are also special transitional rules for 2017 and 2018 related to the premium tax credit.

QSEHRAs Still Subject to Some Code Requirements

A QSEHRA is a self-insured health plan and must pay the Patient-Centered Outcomes Research Trust Fund fee (tax) under Code section 4376. There are special rules for interaction between a QSEHRA and a Health Savings Account tied to a high deductible health plan. If a QSEHRA fails to meet the qualification requirements and the sanction is loss of exemption from being a group health plan, it is important to note that such loss of exemption will impact whether the individual employees' Health Savings Accounts are eligible to receive an allocation of an employer contribution or a deductible contribution by the employee.

Effective Date of Newly Defined QSEHRA Requirements

The New guidance is effective as of November 20, 2017 and it applies to plan years beginning on or after such date.

There is a very short transition rule for currently existing QSEHRAs.

Thank you for taking the time to consider this alert. There are many considerations and operating policies that need to be developed to mitigate an employer's risk related to establishing a QSEHRA. While touted as a great new solution, it is important to consider all of the implications and procedures that will be needed before deciding to establish a QSEHRA. *This is only a summary of some of the highlights of a 60 page notice and careful review of the actual statutes and the Notice must be done before establishing a QSEHRA.*

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