

# Benefits Insights

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## Health Reimbursement Arrangements

Health reimbursement arrangements (HRAs) are plans designed to help employers and employees lower health care costs. Allowed under sections 105 and 106 of the Internal Revenue Code, HRAs enable employers to reimburse employees for out-of-pocket medical expenses not covered by insurance. HRAs are often combined with high-deductible health plan coverage.

### What are HRAs?

HRAs are employer-paid health care arrangements that are often paired with high-deductible health plans to lower health care costs. Typically, an employer creates an unfunded HRA account for each participating employee and reimburses the employee up to the HRA's account balance for substantiated medical expenses not covered by insurance, such as insurance deductibles and copayments.

### How do HRAs work?

If an employer chooses to offer an HRA, it establishes eligibility rules, a maximum reimbursement amount and a list of eligible expenses. (This list must comply with section 213(d) medical expenses as defined in the Internal Revenue Code.) After incurring medical expenses, employees submit claims to the HRA administrator for reimbursement.

### Tax implications

For employers, all HRA reimbursements are tax-deductible. For employees, contribution amounts made by employers are tax-free and reimbursements for medical expenses are also tax-free.

### Advantages

Employers benefit from offering HRAs by reducing insurance costs and restructuring health benefits. By moving employees to high-deductible health plans, costs are more predictable and controlled as employees are encouraged to become

better health care consumers. HRAs motivate employees to make better health care and future planning decisions.

Employees benefit from the protection HRAs provide against catastrophic medical costs. HRA funds can be used to cover a wide range of health care expenses, but unlike health flexible spending accounts (FSAs), HRAs can be designed to allow funds to be carried over year to year. However, unused HRA amounts may not be cashed out—only carried over to the following year. Also, employers may establish account caps on total HRA account balances and include rollover maximums on carryover balances.

### What expenses are not eligible for reimbursement through HRAs?

The following expenses are considered ineligible for HRA reimbursement:

- Medical expenses not defined as eligible under an employer's plan
- Medical expenses that do not meet the definition of "medical care" under Internal Revenue Code section 213(d)
- Medical expenses incurred by an employee, employee's spouse or any eligible dependents prior to the effective date in the program
- Medical expenses that can be reimbursed to an employee through another source, such as group health insurance



### Basic HRA legal requirements

1. **Only Employer Contributions** – HRAs must be funded solely with employer contributions. No direct or indirect employee contributions are allowed.
2. **No Cafeteria Plan Funding** – An HRA can be offered with a group health plan that is offered under a cafeteria plan; the HRA itself may not be funded with pre-tax salary reductions or otherwise under a cafeteria plan.
3. **Reimbursements for Certain Individuals Only** – An HRA may reimburse medical care expenses only if they were incurred by employees or former employees (including retirees) and their spouses and tax dependents. This also includes adult children who are under age 27 as of the end of the taxable year. HRA coverage must be in effect at the time the expense is incurred.
4. **Reimbursements for Certain Medical Expenses Only** – HRAs may reimburse only substantiated medical expenses described in Internal Revenue Code section 213(d). Such expenses include out-of-pocket medical expenses, dental and vision expenses and prescription drugs.  

Under the Affordable Care Act (ACA), HRAs may be used to reimburse the cost of over-the-counter medicines or drugs only if they are purchased with a prescription. This rule does not apply to reimbursement for the cost of insulin, which is permitted even if the insulin is purchased without a prescription.
5. **No Cash-Out of Unused Amounts** – Unused HRA amounts cannot be cashed out and can only be used for reimbursement of medical care expenses. If an HRA includes a spend-down feature, terminated employees can spend down their HRA balances for medical expenses incurred after termination. After an employee's death, only reimbursement of qualifying medical expenses of a surviving spouse or tax dependent is allowed.
6. **COBRA** – COBRA applies to an HRA. The legal issues surrounding COBRA and HRAs are complex, so consult with legal counsel.
7. **Coordination with Health FSA** – HRA may be coordinated with a health FSA to modify which pays first. If no rule is established, the HRA pays first and the health FSA pays last.
8. **Section 105 Nondiscrimination Rules** – Nondiscrimination rules apply to self-insured medical plans and consequently are applicable to most HRAs. Under these rules, a self-funded HRA cannot discriminate in favor of highly compensated employees, and must satisfy the eligibility and benefits tests.
9. **HIPAA Rules** – An HRA is a health plan that is subject to HIPAA's privacy and security rules.
10. **ERISA** – An HRA is a welfare benefit plan and is covered under ERISA unless it is a governmental or church plan.

### Permissible HRA Designs

The ACA's market reforms (for example, the prohibition on annual limits) restrict the types of HRAs that employers can offer. Most stand-alone HRAs are prohibited due to the ACA's reforms, although HRAs that are integrated with other group health plan coverage are permissible. Permissible HRA designs include the following:

- HRAs that are integrated with other group health plan coverage will not violate the ACA's market reforms, as long as the group health plan coverage complies. An HRA is considered integrated with an employer's group health coverage if, under the terms of the HRA, the HRA is available only to employees who are enrolled in another group health plan that does not consist solely of excepted benefits and certain other criteria are satisfied.
- Stand-alone HRAs (or HRAs that do not meet the requirements for integration) are not permitted, unless the HRA qualifies for an exception. For example, retiree-only HRAs are not subject to the ACA's market reforms and may be offered on a stand-alone basis. Prior to 2020, employers couldn't offer a stand-alone HRA for employees to purchase individual coverage, inside or outside of an Exchange, without violating the ACA's market reforms and risking exposure to severe financial penalties. (Beginning in 2020, employers may use an

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individual coverage HRA to reimburse eligible employees for individual health insurance premiums, subject to certain requirements.)

- A qualified small employer HRA (or QSEHRA) is an exception to the prohibition on stand-alone HRAs. Small employers that do not maintain traditional group health plans can use a QSEHRA to reimburse employees' out-of-pocket medical care expenses, including premiums for individual health insurance policies. Only small employers that are not subject to the ACA's employer shared responsibility rules may adopt QSEHRAs. Additional design requirements, including a maximum benefit limit, apply to these HRAs.

Effective for 2020 plan years, employers have the following two additional HRA options available to them:

- As an alternative to traditional group health plan coverage, employers may use an individual coverage HRA to reimburse the cost of individual market premiums on a tax-preferred basis, subject to certain conditions.
- Employers that offer traditional group health plan coverage may provide a non-integrated HRA of up to \$1,800 per year (as adjusted) to reimburse certain qualified medical expenses.

### How do HRAs compare or differ from FSAs and HSAs?

HRAs are the only tax-favored accounts among this group that are owned and funded solely by employers. Unlike health FSAs and HSAs, there are no prescribed limits set by the IRS for HRAs. Also, unlike health FSAs but similar to HSAs, the uniform coverage rule does not apply to HRAs. Also, unlike health FSAs, but similar to HSAs, HRA funds can be rolled over from year to year.

### HRA and health FSA rules

HRAs are generally but not always health FSAs, yet are not subject to the following FSA rules:

- Prohibition against carrying unused benefits into future plan years does not apply.

- The mandatory 12-month period of coverage does not apply, which gives employers more flexibility in designing an HRA.
- The uniform coverage rule does not apply, so the maximum amount of reimbursement under an HRA does not have to be available at all times during the period of coverage.
- An expense incurred by a participant in one year may be properly paid out of the HRA balance attributable to a subsequent year, provided that the individual was a participant when the expense was incurred and remains a participant in the subsequent year.

### HRA and HSA comparison

- No HDHP is required. HRAs combined with another health plan allow for additional flexibility. Group health plan covered offered with an HRA does not have minimum deductibles or maximum out-of-pocket limitations.
- HRAs give plan sponsors more control (for example, employers can decide whether the HRA will forfeit balances at termination, and they can choose what qualified medical expenses the HRA will cover).
- HRAs have no limits on how much an employer can contribute in any given month, year or other coverage period.
- HRAs are not subject to the comparable contribution requirements but are subject to Internal Revenue Code section 105 nondiscrimination requirements.
- HRAs require less coordination with other plans than is required by an HSA.
- HRAs do not have to be funded and are often simply credits that are not backed by actual contributions.

### Coordination of benefits issues

- An individual may not have a general purpose HRA and contribute to an HSA.
- An individual may have certain types of HRA coverage and still be eligible for an HSA:
  - Limited purpose HRA

- Suspended HRA
- HDHP with post-deductible HRA coverage
- Retirement HRA
- Combination of the above

to certain expenses or designed to permit reimbursements after the HDHP deductible has been met.

- Expenses an HRA can reimburse are limited to qualified medical expenses; however, an employer may choose to be more restrictive on what the plan will reimburse.

### Key plan design questions

- **Stand-Alone HRA or HRA + health plan?**

- Stand-Alone
  - Limited availability due to the ACA's annual limit prohibition
  - Retiree-only
  - Reimbursement for excepted benefits, for example, dental or vision expenses
  - QSEHRA
  - Individual coverage HRA (effective for 2020)
  - Preserve HSA eligibility (depending on design)
- HRA/Health Plan
  - High flexibility
  - Employer can limit the availability of HRA COBRA coverage to qualified beneficiaries who also elect health plan's COBRA coverage.

- **Who will be eligible to participate?**

As long as the HRA passes nondiscrimination testing, employers can cover all employees, only those participating in the health plan, only retirees or a limited class of employees. However, to be considered integrated with other group health coverage for purposes of the ACA's annual limit rules, HRA eligibility must be restricted to employees who are enrolled in other group health plan coverage (regardless of whether the employer sponsors the other group health coverage). Self-employed individuals, including partners in a partnership and more than 2% shareholders in an S corporation cannot participate in an HRA on a tax-favored basis.

- **What expenses are reimbursable?**

- If an HRA is offered along with an HSA/HDHP, HRA coverage must be limited

- **How much will the employer contribute?**

There is no specified cap on the amount an employer is allowed to contribute to an HRA. However, nondiscrimination rules apply to the benefits provided under HRAs. Employers must be careful to structure HRA contributions so that they do not discriminate in favor of highly compensated employees. An employer can choose to credit an employee's HRA account once per year, on a pro rata monthly basis or on each payday.

- **How will the HRA be funded?**

HRAs must be funded solely by the employer and may not be part of a cafeteria plan. Employers must decide whether the HRA will be funded through a separate account or whether reimbursements will be made from employer general assets (unfunded). Most employers maintain their HRAs on an unfunded basis.

- **Will carryovers be allowed?**

Employers may allow carryovers of unused account balances on HRAs, but they don't have to. Employers can allow unlimited carryovers or put limits on carryovers. Caps can be placed on the carryover amounts and plan sponsors can also set a maximum contribution each year.

- **How will reimbursements be processed?**

Because substantiation is required for HRA reimbursements, and due to privacy concerns, employers may consider hiring a third-party administrator (TPA) to substantiate claims. Employers should complete a due diligence of TPAs and have service agreements and business associate contracts reviewed by counsel. Employers should also consider if they want caps on reimbursements. If the employer also sponsors a health FSA, the employer should consider how the claims will be ordered.

- **Forfeit account balances or permit spend-downs?**  
An employer may choose either to forfeit unused amounts in an employee's HRA when the employee terminates employment or allow employees to spend down their accounts. COBRA must be offered.

HRAs may or may not be the right solution for all employers. Please contact your Benefit Team Insurance Services representative for assistance in determining what tax-advantaged account will best meet your goals.