

November 07, 2017

IRS Issues Detailed QSEHRA Guidance

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The Internal Revenue Service (IRS) has issued detailed guidance on the qualified small employer health reimbursement arrangement (QSEHRA) program established by Congress last December.



Topics addressed in [Notice 2017-67](#) include QSEHRA eligibility, notices, substantiating expenses, interaction with health savings accounts (HSAs), and the consequences if applicable rules are not met. The guidance, released October 31, also explains the effect of a QSEHRA on an individual's eligibility for [Affordable Care Act](#)(ACA) premium subsidies.

The [21st Century Cures Act](#), signed December 13, 2016 (Pub. L. 114-255), created QSEHRAs for use by certain small employers. QSEHRAs were excluded from the “group health plan” definition in the tax code and other benefits laws, meaning they could be offered on a stand-alone basis without running afoul of the ACA’s prohibition on lifetime and annual limits.

Like traditional HRAs, a QSEHRA must be funded solely by the employer and reimburse medical expenses as defined by Internal Revenue Code Section 213(e). It must be provided on the same terms to all eligible employees, except that the benefit amount may vary to reflect differences in individual health insurance premiums that are based on age and family size. Certain categories of employees may be excluded from coverage.

Another impetus for HRA expansion was provided by President Trump in [Executive Order 13813](#), issued October 12. Among other things, the order directs federal agencies to look for ways to broaden HRAs’ availability, especially in connection with nongroup health coverage.



“The guidance provided in this notice addresses each of those objectives,” the IRS stated in Notice 2017-67. “The Treasury Department (Treasury) and the [IRS] anticipate that the Departments will issue additional guidance in the future in response to Executive Order 13813.”

Treasury and the IRS are accepting public comments on the guidance until January 19, which the agencies plan to take into account as they craft the guidance into proposed regulations.

Eligible Employers

To be eligible to offer a QSEHRA, an employer must not be an “applicable large employer” under the ACA or offer a group health plan to any of its employees. “An employer is not an eligible employer for any month during which the employer offers a group health plan to its employees that would provide coverage on any day of the month,” according to Notice 2017-67.

However, offering a group health plan solely to former employees such as retirees does not render an employer ineligible. Nor does contributing to an employee’s HSA.

Eligible Employees

An “eligible employee” generally means any employee of an eligible employer, except that employers may exclude certain categories. A QSEHRA may only be provided to employees—not retirees, other former employees, or non-employee owners.

An employee may not waive participation in a QSEHRA; it must be provided (rather than simply offered) on the same terms to all eligible employees. “The arrangement must be operated on a uniform and consistent basis with respect to all eligible employees,” the IRS noted. However, employees still may be reimbursed different amounts if they submit different expenses. The reimbursement limit also may vary based on the age or number of individuals on a particular employee’s coverage.

An employer is not required to set its QSEHRA reimbursement limits at the statutory maximums (for 2018, \$5,050 for self-only coverage and \$10,250 for family coverage). It may select a percentage of these limits, impose the same limit whether an employee has self-only or family coverage, or cover only certain types of expenses (such as premiums or cost-sharing).

However, an employer may not reimburse one category of employees for all medical expenses and another just for insurance premiums, or reimburse a family differently depending on whether the family members have the same or multiple policies. If an employer decides not to exclude an otherwise excludable category of employees, such as part-time or seasonal employees, it must provide them a QSEHRA on the same terms as all employees.

Notices

The Cures Act requires employers to issue advance notice of QSEHRA availability, but the IRS originally postponed this requirement until more detailed guidance could be issued. “This notice constitutes such guidance,” Notice 2017-67 stated. “An eligible employer that provides a QSEHRA during 2017 or 2018 must furnish the initial written notice to its eligible employees by



the later of (a) February 19, 2018, or (b) 90 days before the first day of the plan year of the QSEHRA.”

The IRS also encouraged employers “to provide employees with information regarding the QSEHRA as soon as possible to allow employees to make informed decisions about health coverage, even if that information is less than the full notice required.”

As employees become newly eligible for a QSEHRA, the notice must be furnished to them on or before the eligibility date.

Notice 2017-67 also details the required contents of a notice, including sample language.

Reimbursement

All claims for QSEHRA reimbursement must be substantiated as medical expenses. The same substantiation requirements apply as for health [flexible spending accounts](#). If an employer pays an insurance premium directly to the insurer instead of reimbursing the employee, then no additional substantiation will be required.

To be reimbursed, an employee must provide proof, either by documentation or attestation, that he or she has “minimum essential coverage” (MEC) under the ACA’s individual mandate.

If a QSEHRA mistakenly reimburses an employee for a non-medical expense, or one that has not been substantiated, then “all payments to all employees under the arrangement, substantiated and unsubstantiated, on or after the date the mistaken reimbursement was made, become taxable,” the IRS stated. This consequence can be avoided if the employee fixes the problem in timely fashion either by providing the needed substantiation or by repaying the amount with after-tax funds.

Any cash-out of unused QSEHRA funds at year’s end also would render all payments to all employees includible in income, the IRS warned.

A QSEHRA may reimburse the health insurance premiums of an employee’s family member who is on a separate policy from the employee, or premiums for coverage under a group health plan sponsored by the employee’s spouse’s employer—but the reimbursements are taxable to the extent the premiums were paid pre-tax.

Payments or reimbursements may be made immediately once an employee becomes eligible to participate, but not for medical care received before this date. A QSEHRA may not impose a deductible or cost-sharing requirements that must be met before medical expenses will be reimbursed.

Reporting

The employer must report the amount of payments and reimbursements that an eligible employee is entitled to receive from the QSEHRA for the calendar year, regardless of how much amount the employee actually received, in box 12 of the Form W-2 using code FF. However, a QSEHRA does not trigger Form 1095-B reporting requirements under the ACA.



Penalties

An arrangement that fails to satisfy the QSEHRA requirements will be deemed a group health plan subject to the ACA's market reforms, such the prohibition on annual dollar limits, which are punishable by excise taxes of up to \$100 per affected person per day. This is the case if the arrangement:

- Is provided by an ineligible employer (for example, one that offers another group health plan to its employees);
- Is not provided on the same terms to all eligible employees;
- Reimburses medical expenses without first requiring proof of MEC; *or*
- Provides a permitted benefit in excess of the statutory dollar limits.

However, if an arrangement is designed to reimburse expenses other than medical expenses (or not just medical expenses), then it is neither a QSEHRA nor a health plan and the consequence is inclusion of all payments in employees' gross income and wages. Failure to provide the required notice is subject to a penalty of \$50 per employee, up to a maximum of \$2,500 annually per employer.

Interaction with HSAs

An individual with a QSEHRA will not be eligible for an HSA if the QSEHRA, by its terms, may reimburse any medical expense including cost-sharing. However, the individual still may be HSA-eligible if the QSEHRA may reimburse only health insurance premiums, permitted insurance, or other "disregarded coverage" such as accident, disability, dental, or vision.