

IRS Offers Employers a Peek at Future Guidance on I-HRAs

November 2018

Notice 2018-88 suggests how I-HRAs can meet employer mandate, affordability/minimum value rules, and nondiscrimination rules

Less than a month after the Trump Administration issued proposed regulations expanding the use of health reimbursement arrangements (HRAs) to include purchasing individual health insurance policies sold in the individual insurance market and on the public Exchanges, the Internal Revenue Service (IRS) issued Notice 2018-88 addressing how the expanded use of HRAs might satisfy the Affordable Care Act (ACA) employer mandate and how the IRS anticipates modifying the Internal Revenue Code's nondiscrimination rules to apply to the new HRAs, known as individual coverage HRAs (I-HRAs).

How an Employer Can Avoid the ACA's Employer Mandate Penalties by Offering an I-HRA

Violating the employer mandate results in two potential penalties: the larger 4980H(a) penalty and the generally smaller 4980H(b) penalty. The Notice states that an employer can avoid both penalties by offering a properly structured I-HRA.

Avoiding the 4980H(a) Penalty

Under the employer mandate, an employer must offer minimum essential coverage to at least 95% of all full-time employees and their eligible non-spouse dependents to avoid a monthly penalty. If the employer does not satisfy this mandate and a full-time employee receives a premium tax credit, the penalty is currently \$2,320 multiplied by the number of full-time employees (minus 30), regardless of whether those employees were offered minimum essential coverage.

By offering a properly structured I-HRA (e.g., verifying an employee's enrollment in individual coverage, forfeiting the HRA for months of non-enrollment, etc.), an employer would not be liable for the 4980H(a) penalty if the I-HRA is offered to at least 95% of all full-time employees and their eligible non-spouse dependents. The I-HRA does not have to be affordable or provide minimum value for the employer to be insulated from the 4980H(a) penalty.

Avoiding the 4980H(b) Penalty

Offering an I-HRA could also insulate an employer from the generally smaller Code Section 4980H(b) penalty if the I-HRA is affordable and offers minimum value. Under Code Section 4980H(b), if a full-time employee enrolls in an Exchange and is eligible for a premium tax credit, the employer will be liable for the 4980H(b) penalty for each such employee (currently \$3,480) if such coverage was unaffordable or did not meet minimum value. Whether individual health insurance coverage is "affordable" depends on several factors, including an employee's age, rating location, and household income. These data points vary from employee to employee.

Affordability and the I-HRA

An I-HRA is affordable if the cost of the individual health insurance coverage minus the HRA amount provided by the employer (the employee's "required HRA contribution") does not exceed the "required contribution percentage" (9.86% for 2019) of the employee's household income. To determine affordability, an employer must determine: the policy to be used; the rating location of the policy; the cost for a specified period of coverage; and the age of the covered employee.

The IRS anticipates issuing several safe harbors addressing how to determine these data points.

- Affordability would be determined using an "affordability plan," which would be the lowest cost silver plan for the employee for self-only coverage offered by the applicable Exchange based on where the employee resides. The IRS anticipates issuing a safe harbor permitting an employer to use the rating area in which the employee's primary employment site is located as the location of the employee's individual health insurance.
- The IRS also anticipates issuing a safe harbor that would permit the use of the prior calendar year's cost of the affordability plan for a calendar year plan year.
- In the case of a non-calendar year plan year, the IRS anticipates issuing a safe harbor permitting an employer to use the cost of the affordability plan for the first month of the plan year as the cost for the full plan year.
- The IRS also anticipates that future guidance will permit an employer to use the "standard" affordability safe harbors under Code Section 4980H (IRS Form W-2, the rate of pay, and the federal poverty line safe harbors) instead of an employee's household income when determining if an employee's required contribution is "affordable," subject to similar requirements applied today in the case of traditional group health plans.

Minimum Value and the I-HRA

As set forth in the proposed regulations, an I-HRA that is treated as affordable would also be treated as offering minimum value.

Reporting Coverage Under an I-HRA

The IRS anticipates that future guidance would require reporting the affordability of an I-HRA on Form 1095-C, using the employee's required contribution as determined under the safe harbors described in the Notice.

The Internal Revenue Code's Nondiscrimination Rules and the I-HRA

Since the price of individual health insurance is rated according to an individual's age and the cost of the insurance increases as the individual's age increases, an employer might design an I-HRA that provides greater contributions for older employees. An HRA, however, is subject to the nondiscrimination rules of Code Section 105(h), which prohibit self-funded plans from discriminating in favor of highly compensated individuals in eligibility or benefits and prohibit a self-funded plan from basing employer contributions on age or years of service. Failure to satisfy these rules would cause a highly compensated individual to include payments from an HRA in income.

The proposed regulations allow I-HRAs to differentiate among specific classes of employees. An employer would be able to provide different levels of HRA contributions to each of those specific classes, as long as the same HRA contribution is provided on the same terms to all employees within a class.

To address the increasing cost of individual insurance as age increases, the IRS anticipates an exception to the nondiscrimination rules that would permit the maximum I-HRA dollar amount made available to an employee for any plan year to increase as the age of the employee and the price of individual health insurance coverage in the relevant individual insurance market increase. Such an increase must be made available to all employees who are members of the same class who are the same age. The IRS requests comments by December 28, 2018,

regarding the use of age bands or other assumptions about an employee's age that could ease administrative burden.

Resources

IRS Notice 2018-88 is available [here](#).

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