

HRA

-Health Reimbursement Arrangement-

June 2002

Rev. Rul. 2002-45

IRS Notice 2002-45

It's the old Medical Reimbursement Plan or Sec 105 Plan polished up

HRA Summary

- ▶ HRA must be funded solely by employer
- ▶ No employee contributions
- ▶ HRA can only reimburse substantiated medical care expenses under Code Sec 213
- ▶ For employees, spouse and tax dependents or former employees and retirees (unless excluded)
- ▶ Claims after plan inception
- ▶ No cash out of unused account
- ▶ May allow terminated employees to file claims against balance
- ▶ Benefit subject to COBRA

Stand-Alone HRA

- ▶ No requirement to participate in the group insurance
- ▶ Benefits available to all who meet eligibility requirements

HRA + HDHC Arrangement

- ▶ HRA benefit requires insurance participation
- ▶ Typically high deductible policy
- ▶ Define deductible level or out of pocket limit

How To Establish an HRA

- ▶ Adopt a plan document
- ▶ Communicate to employees

Eligible Employees

- ▶ May have minimum age and service for employees to be eligible
- ▶ Must be a C-Corp for owner participation
- ▶ Excludes self-employed, partners, and more than 2% Sub-S shareholders

Spouse & Dependents

- ▶ May be covered or not

Eligible expenses

- ▶ Same as Cafeteria Plan, Sec 213 Expenses.

See Publication 502 at www.CafeteriaPlan.com

- ▶ May also allow health insurance reimbursement (possible HIPAA problems)
- ▶ Design options: Have a deductible.
Reimburse 80% of out of pocket expenses

Spouse & Dependents continued

Annual Limit

- ▶ No limit
- ▶ Amount chosen may be available Jan 1, or accrued monthly
- ▶ Reimburse only up to accrual
(no advance funding like Cafeteria Plan)

Year End Carry Forward

- ▶ Big advantage, but not required. May cap the carryover amount

Forfeit vs. Spend Down

- ▶ Employer may choose to forfeit unused amounts on termination or allow employee to spend down COBRA. Must be offered either way

Year End Carry Forward continued

Funded vs. Unfunded

- ▶ Most unfunded. Paid from company assets. Funded requires trust reporting. VEBA plan doc + Sec 419 & 419A deduction limits

Single/ Two Party/ Family

- ▶ Possible, but beware of discrimination

Administration Costs

- ▶ HRA may fund administration costs for retired or terminated employees

Claims Substantiation/COBRA

- ▶ Same as Cafeteria Plan. Requires full documentation prior to reimbursement
- ▶ COBRA
- ▶ HRA is a group health plan subject to COBRA
- ▶ May design plan to link COBRA election of insurance & HRA (can't take HRA without insurance)
- ▶ Terminated employee on COBRA gets new annual employer contribution
- ▶ Employee has \$3,000 HRA account and gets divorced. Spouse may elect COBRA and also get \$3,000. Annual HRA accrual goes to both.

Claims Substantiation/COBRA continued

Determining COBRA Premium

- ▶ This one gets fuzzy

HRAs must satisfy non discrimination requirements of Sec. 105

- ▶ May not discriminate as to eligibility and benefits. May not base reimbursement on compensation, age or years of service

XVIII Health Reimbursement Arrangements (HRAs) and Defined Contribution Health Plans

subsections that follow, we discuss the tax and compliance issues for HRAs in detail. Health FSA and Archer MSA issues are discussed elsewhere.¹⁵

Plan Design or Compliance Issue	Health FSAs	HRAs	Archer MSAs
Internal Revenue Code			
Salary reduction funding	Permitted	Not permitted for HRA but permitted for HDHC	Not permitted, but permitted for the underlying HDHC. In addition, the MSA may be funded with deductible employee contributions.
Carry-over of unused amounts	Not permitted	Permitted	Permitted
Medical expenses that are eligible for reimbursement	Otherwise unreimbursed Code § 213(d) medical expenses incurred during the coverage period. Cannot reimburse insurance premiums. Cannot reimburse qualified long-term care services.	Otherwise unreimbursed Code § 213(d) medical expenses incurred while coverage in effect, including premiums for eligible health insurance and long-term care insurance. Cannot reimburse qualified long-term care services so long as the HRA is an FSA.	Otherwise unreimbursed Code § 213(d) medical expenses incurred while coverage in effect, but not expenses for insurance other than premiums for COBRA, a qualified long-term care contract, or for a health plan while the individual is receiving unemployment compensation.
Cash-outs of unused amounts (if no medical expenses)	Not permitted. But see discussion of experience dividends in Section XX.	Not permitted	Permitted but such amounts are taxable and subject to an excise tax.
12-month period of coverage & prohibition of mid-year changes	Applies	Does not apply	Does not apply
Health FSA uniform coverage requirement	Applies → i.e. maximum amount of coverage must be	Does not apply → i.e. coverage level may be	Does not apply

Health FSA uniform coverage requirement	Applies—i.e. maximum amount of coverage must be available throughout coverage period (generally 12 months)	Does not apply—i.e. coverage level may be prorated by plan design	Does not apply
Ability to spend down unused amounts after termination of active participation	Cannot use unused amounts to pay for claims incurred after termination but COBRA rights may apply	HRA can permit unused amounts to be used until depleted to pay for claims incurred after termination and COBRA rights will apply too	Subject to certain restrictions can permit unused amounts to be used up
Claims must be incurred during current period of coverage	Applies	To a certain extent, does not apply—i.e., claims incurred but not reimbursed in an earlier period while the individual was a participant can be reimbursed in subsequent year if individual still a participant	Unclear
Expense substantiation	Required	Required	Required
Claims adjudication	Required	Required	Not required

¹² Note that when an HRA is coupled with HDHC the combined arrangement may look and operate very much like an Archer MSA. There are significant differences, however. For example, HDHC coverage that is provided in conjunction with an HRA does not need to qualify as Archer MSA-eligible HDHC coverage under Code § 220. Sponsors of an HRA+HDHC arrangement have more freedom in plan design (e.g., the HDHC deductible is not required to be within the range prescribed by Code § 220 for an Archer MSA+HDHC). But unlike Archer MSAs, which do not have an independent claims adjudication requirement, no reimbursements can be made under a health FSA or HRA without independent claims adjudication. Finally, employee contributions cannot be made to an HRA on a pre-tax salary reduction or other tax-advantaged basis, while Archer MSAs may be funded through deductible employee contributions.

Plan Design or Compliance Issue	Health FSAs	HRAs	Archer MSAs
Ordering rules	Required Generally health FSAs must be payors of last resort But can draft HRA and health FSA plan documents so HRA pays only after health FSA amounts are exhausted	Generally health FSAs must be payors of last resort But can draft HRA and health FSA plan documents so HRA pays only after health FSA amounts are exhausted	In general an individual is not eligible to have an MSA if while covered under a high deductible health plan she is covered under any other health plan (including an HRA or health FSA) which provides coverage for any benefit which is covered under the high deductible health plan
Code § 105(h) nondiscrimination requirement	Applies	Applies	Does not apply but if employer makes contributions Code § 4980E requires comparable contributions be available for comparable participating employees
Is a trust account required?	No not by the IRC but possibly by ERISA (no trust if health FSA complies with ERISA Tech Reg 92-01 including that reimbursements are made directly out of the general assets of the employer)	No not by the Code but possibly by ERISA (no trust if HRA reimbursements are made directly out of the general assets of the employer)	Yes
Are account earnings taxable?	Not applicable if reimbursements are made directly out of the general assets of the employer If funded with a VEBA earnings are generally not taxable	Not applicable if reimbursements are made directly out of the general assets of the employer If funded with a VEBA earnings are generally not taxable	No
ERISA (for ERISA-covered employers)			

ERISA (for ERISA-covered employers)			
Funding requirement	Not required There is no requirement to set funds aside in a separate account, if an employer does so ERISA's trust requirement may apply	Not required Employers may decide to fund (i.e., set aside funds) as potential liability increases But any such funding may invoke ERISA's trust requirement	Employer and employee MSA contributions required to be put in trust
ERISA plan asset issues	Even though a plan may be treated as "unfunded" under ERISA Tech. Rel. 92-1 salary reduction amounts are plan assets for purposes of ERISA's exclusive benefit and fiduciary duty rules	Generally no plan assets unless funded (i.e., generally no plan assets if all reimbursements paid directly out of general assets of employer)	For plans with employer contributions, generally employer and employee contributions would be plan assets once placed in MSA trust
ERISA Form 5500	Applies Exception for small (fewer than 100 participants) unfunded plan	Applies Exception for small (fewer than 100 participants) unfunded plan	Applies if there are employer contributions to the MSA trust
ERISA SPD and other disclosures and adherence to ERISA's benefit claims procedures	Required	Required	Applies if there are employer contributions
HIPAA			
Portability, certificates of creditable coverage, and health status nondiscrimination	Applies Exception for most health FSAs funded with salary reductions	Applies Health FSA exception generally not available	Applies to HDHC component

¹³ Health FSAs are discussed in Sections XIX, XX, and XXI, and Archer MSAs are discussed in Section XXXVII.

XVIII Health Reimbursement Arrangements (HRAs) and Defined Contribution Health Plans

Plan Design or Compliance Issue	Health FSAs	HRAs	Archer MSAs
Privacy	Applies	Applies	Does not apply to employer-funded self-administered MSA or to MSAs receiving no employer contributions. Would apply to HDHC component and MSAs that are not self-administered.
COBRA	Applies. There is a special rule for qualifying health FSAs.	Applies. Special rule for qualifying health FSAs generally not available.	Does not apply to MSA component. May apply to HDHC component.

F. HRAs Must Be Funded Exclusively by Employer and Not With Salary Reductions or Otherwise Under a Cafeteria Plan

As a general rule, HRAs must be funded solely by the employer, and not with salary reductions or otherwise under a cafeteria plan.

In many cases, compliance with this requirement can be easily demonstrated. For example, an HRA satisfies this funding restriction when the HRA is a stand-alone HRA that is funded solely by the employer outside of its cafeteria plan (thus, no salary reductions or flex credits are used to pay for the HRA coverage) and is provided to all employees (even to those that do not participate in the employer's HDHC).

Determining whether the HRA is funded exclusively by the employer is more difficult when the HRA is coupled with HDHC that is funded by salary reductions or otherwise under a cafeteria plan.

The 2002 IRS guidance provides that an HRA must be "paid for solely by the employer and not provided pursuant to a salary reduction election or otherwise under a § 125 cafeteria plan."¹⁴ Thus, an HRA cannot be funded directly or indirectly by a cafeteria plan. This does not mean that the HRA cannot be offered in conjunction with a major medical plan (e.g., HDHC) that is funded in part with employee pre-tax salary. The 2002 IRS guidance makes it clear that an HRA can be linked with a major medical plan.

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