Proposed Rules to Expand HRAs Part 3: The Impact of Individual Coverage HRAs on PTC Eligibility (IRC Section 36B) and the Employer Shared Responsibility Mandate (IRC Section 4980H)

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This article is Part 3 in our series of articles on the recent proposed rules issued by the Department of Labor, the Treasury Department and the Department of Health and Human Services expanding and increasing the flexibility of Health Reimbursement Arrangements, or HRAs starting in 2020 (see Part 1 and Part 2). This article will focus on individual coverage HRAs and their impact on an individual’s ability to qualify for a premium tax credit under IRC Section 36B and an employer’s potential liability for an assessable payment under the employer shared responsibility mandate of IRC Section 4980H.

As outlined in our prior articles, the proposed regulations make HRAs more flexible so that employees are permitted to use amounts in an HRA integrated with individual coverage (called an “individual coverage HRA”) to pay expenses for medical care including premiums for individual health coverage, provided certain requirements are satisfied. See Part 2 of our series of articles for the requirements applicable to an individual coverage HRA.

Eligibility for PTC under IRC Section 36B

Under previously issued guidance, an individual who is covered under an HRA is ineligible for the premium tax credit (PTC) provided under IRC Section 36B. An individual offered coverage under an HRA (regardless of whether he or she accepts the coverage) is ineligible for a PTC if the coverage is both affordable and provides minimum value. The proposed regulations set out rules for determining when an individual coverage HRA is affordable and provides minimum value for this purpose.

For determining eligibility for a PTC, under the proposed rules an individual coverage HRA is affordable for an employee for a calendar month, if the employee’s “required HRA contribution” (a fictional amount, not an actual required contribution) is not more than 9.5% (as adjusted) of the employee’s household income for the calendar year divided by 12. The “required HRA contribution” is the excess of the monthly premium for the lowest cost silver plan for self-only coverage available to the employee through the Exchange for the rating area in which the employee resides (the “HRA affordability plan”) over the self-only HRA amount newly available to the employee under the HRA for the plan year, divided by the number of months the HRA is available to the employee. In the case where the HRA provides one amount regardless of the number of individuals covered, the amount by which the HRA affordability plan premium is reduced to determine the required HRA contribution is the monthly maximum amount newly made available to the employee under the HRA for the plan year divided by the number of months the HRA is available to the employee.
The proposed rules provide that for PTC eligibility purposes, an individual coverage HRA, if it is affordable, is automatically deemed to provide minimum value.

**Affordability and Minimum Value Safe Harbors under Section 4980H**

In order to facilitate the use of individual coverage HRAs, the IRS has recently issued Notice 2018-88, which explains how IRC Section 4980H (the employer shared responsibility mandate) would apply to an applicable large employer (“ALE”) that offers individual coverage HRAs to its employees. Under IRC Section 4980H(a), an ALE will owe an assessable payment for a month if it fails to offer at least 95% of its full-time employees and their dependents minimum essential coverage and at least one full-time employee obtains a PTC. Under Section 4980H(b), an employer will owe an assessable payment for a month if it avoids a payment under 4980H(a) and at least one full-time employee obtains a PTC, which can occur because the coverage offered to that employee was either not affordable or did not provide minimum value. The 4980H(b) payment for a month is determined by multiplying the number of full-time employees who obtain a PTC for that month multiplied by $250 (as adjusted). For 2018, the adjusted amount is $290.

An ALE that offers an individual coverage HRA to 95% of its full-time employees and their dependents will not be subject to an assessable payment under 4980H(a). An individual coverage HRA is considered minimum essential coverage.

An ALE, even if it has offered an individual coverage HRA to 95% of its full-time employees and their dependents, can still be liable for an assessable payment under 4980H(b) if the coverage is not affordable or does not offer minimum value. Notice 2018-88 announces that the IRS anticipates issuing guidance that will provide a safe harbor for determining the affordability of HRAs for 4980H(b) purposes. The method described in the notice is similar to the method for determining affordability for purposes of an individual’s eligibility for a PTC under IRC Section 36B, which is described above. For PTC eligibility purposes, the affordability plan (referred to in the notice as the “HRA affordability plan”) is the lowest cost silver plan for self-only coverage offered by the Exchange in the rating area in which the employee resides. For 4980H(b) purposes, the notice proposes using the rating area in which the employee’s primary site of employment is located instead of the rating area in which the employee resides. This “location safe harbor” is designed to make the determination of HRA affordability easier for the employer.

The notice acknowledges the administrative difficulty in determining each employee’s required contribution amount for an HRA because it is based on the premium amount under the applicable affordability plan (the lowest cost silver plan), which in turn is based on the employee’s age. The IRS has asked for suggestions for safe harbors that may ease this administrative burden.

The notice further acknowledges that employers will need to know the cost of the lowest cost silver plan well in advance of the beginning of the calendar year in order to design an HRA plan that is affordable so as to avoid a 4980H(b) assessable payment. Since the Exchanges typically do not announce that information until just before open enrollment – usually around November 1 – the notice proposes to establish a safe harbor that will allow an employer to use the affordability plan for the prior calendar year.
The notice also states that the IRS anticipates issuing guidance that will provide a safe harbor for individual coverage HRAs that have a plan year that spans two different calendar years. The proposed safe harbor would allow an employer to use the cost of the affordability plan for the first month of the plan year as the cost of the affordability plan for all months in the plan year.

In general, whether an offer of coverage is affordable for 4980H(b) purposes is based on whether the employee’s required contribution for the lowest cost self-only coverage offered by the employer exceeds 9.5% (as adjusted) of the employee’s household income. If the required contribution does not exceed 9.5% of the employee’s household income, then the coverage is affordable. Because employers do not typically have access to an employee’s household income, the applicable regulations provide three safe harbors (referred to in the notice as the “HHI safe harbors”) that allow employers to use a substitute amount in place of an employee’s household income. These safe harbors are the W-2 safe harbor, the rate of pay safe harbor, and the federal poverty line safe harbor. The notice states that anticipated guidance will make it clear that employers offering individual coverage HRAs will be entitled to use the HHI safe harbors subject to certain requirements. Generally, the HHI safe harbors apply to the required contribution for the plan offered by the employer. However, in the case of an individual coverage HRA, there is no actual required contribution. Accordingly, the anticipated guidance will clarify that the plan used to determine each employee’s required contribution is the HRA affordability plan or the affordability plan using the safe harbors described in the notice.

Similar to the proposed regulations for determining PTC eligibility, an individual coverage HRA is deemed to provide minimum value for purposes of 4980H(b) if the HRA is affordable, taking into account the safe harbors proposed in the notice and the HHI safe harbors.

If you have any questions about these proposed rules, contact one of our attorneys.