



## COMPLIANCE SERVICES Alert



Dec. 14, 2018

# IRS announces tentative safe harbor rules following proposed HRA regulations

Several weeks ago the IRS proposed regulations that would resuscitate, beginning in 2020, the ability of employers subject to the Affordable Care Act's (ACA) employer mandate to offer their employees health reimbursement arrangements (HRAs) to defray the cost of *individual market* health insurance policies. See our [Alert](#) on the proposed rules.

Those proposed rules, however, did not address how an employer might be able to satisfy the ACA's employer mandate requirements by offering such an HRA. Now the IRS has followed up those proposed rules with a tentative set of safe harbors that would help employers satisfy the employer mandate by offering premium reimbursement HRAs in lieu of group health insurance.

*Lockton comment:* By "tentative" safe harbors we mean the IRS says it anticipates issuing guidance reflecting these safe harbors. In this Alert we refer to these as proposed safe harbors.

## Making sense of the proposed safe harbors

Recall that under the ACA's employer mandate all employers with 50 or more ACA "full time employees" in their controlled group of businesses are subject to a two-tiered obligation under threat of penalty:

1. Offer at least *minimum essential* medical coverage (i.e., at least bare bones coverage) to 95 percent or more of their ACA full-time employees (and the employees' children through the month the children turn age 26), and
2. Offer the employee self-only medical coverage that both meets the ACA's *minimum value* standard (at least 60 percent actuarial value) and satisfies an affordability requirement related to the employee's premium payment obligation.

But before employers subject to the ACA's employer mandate can consider offering HRAs to employees, to reimburse premium expenses for *individual* health insurance policies, the IRS must explain how those HRAs can be structured to meet the employers' obligations under that mandate.

*Lockton comment:* The chore is complicated with respect to the second of the two obligations listed above because the cost, and therefore affordability, of an individual health insurance policy will vary from employee to employee, based on factors including age and residence.

The IRS is proposing that with respect to the 95 percent test described above, a premium reimbursement HRA would be considered an offer of minimum essential coverage, meeting the first tier of the employer mandate obligation.

With respect to the second obligation – to offer minimum value and affordable self-only coverage to the full-time employee – the IRS proposes three new safe harbors to help a premium reimbursement HRA satisfy the affordability component of the employer's ACA employer mandate obligation.

## Affordability safe harbors

### 1. Look to the cost of individual market coverage where the employee *works*

Currently proposed rules would dictate that the affordability of an individual health insurance policy available to an employee would depend on the amount the employee must pay for the lowest cost "silver" plan (at least 70 percent actuarial value) in an ACA marketplace rating area in which the employee lives.

*Lockton comment:* Thus, an employer would have to determine, for each ACA full-time employee, the premium for the lowest-cost silver plan in the ACA marketplace rating area where the employee lives. The employer would then have to ensure that the amount available under the HRA to reimburse at least some of that premium expense is adequate to make the remaining portion of the premium cost paid by the employee "affordable."

The IRS acknowledges that determining the affordability of an individual health insurance policy, for each employee, based on where the employee lives would require a massive administrative undertaking for some employers.

To alleviate some of that burden, the IRS is proposing that employers be allowed to make this affordability determination based on the employee's *principal worksite location*. Thus, the employer would, for an entire group of employees working at the same location, determine the cost of the least expensive silver plan available to each employee in the ACA marketplace rating area encompassing that location.

*Lockton comment:* This would be somewhat helpful, but affordability determinations would still have to be made on an employee-by-employee basis, because premium cost for the cheapest silver plan in that rating area will still vary with the employee's age. The IRS recognizes this and solicited suggestions from the employer community regarding approaches, such as using age bands, that might lessen that burden.

## 2. Look to individual market premium cost for *prior* – not current – year

Another administrative challenge with determining affordability of any given employee's individual market premium is that individual market premiums for the upcoming calendar year are announced late in the prior year, after many employers have completed planning for the upcoming year's health insurance costs.

To address this concern the IRS proposes to allow employers with calendar year HRAs to determine the affordability of an HRA-reimbursed individual market health insurance policy by considering the cost of that policy for the *prior* year.

*Lockton comment:* An employer could use the second safe harbor in addition to the first safe harbor, the location safe harbor.

The lookback rule would thus lock in the prior year's individual market premium cost for the *current* year, for purposes of determining whether, for the current year, the employer's HRA benefit makes the lowest cost silver plan available to the employee in the individual market "affordable" for ACA purposes.

*Lockton comment:* The lookback rule protects the employer from individual market premium increases for the new year. For example, it protects an employer that sets in mid-2019 the amount of its HRA premium reimbursements for 2020, only to find weeks later that 2020 premiums have spiked.

## 3. Employers with non-calendar year HRAs can determine affordability of individual market premium cost based on the cost for the first month of the HRA plan year

Along the same line as safe harbor number two, an employer with a non-calendar year HRA could lock in an employee's individual market premium cost for the first month of the HRA plan year and apply that for the *entire* plan year, for purposes of affordability determinations.

*Lockton comment:* For example, an employer might maintain an individual market premium reimbursing HRA with a July 1 to June 30 plan year. An employee buying individual market health insurance will pay one rate for July 1 through Dec. 31 of 2020, but a different (likely higher) rate for Jan. 1 through June 30, 2021, the first half of the next policy year but the last half of the HRA plan year.

The safe harbor would allow the employer to make affordability determinations for that employee for the entire HRA plan year based on the employee's premium cost for July 2020. The employer could use this third safe harbor in conjunction with the first, the location safe harbor.

## Existing employer mandate affordability safe harbors

The proposed safe harbors listed above are designed to ease the employer's effort to determine any full-time employee's *premium cost* for the cheapest individual policy providing silver-level actuarial value in the relevant individual market rating area. But the employer's work doesn't end there.

The employer must then determine whether, after accounting for the HRA benefit made available to the employee to offset that premium cost, the employee's net premium obligation is "affordable" for employer mandate purposes. The cost is affordable if the employee is not required to pay more than 9.5 percent (adjusted annually for inflation) of the employee's household income for self-only coverage.

With respect to an employer's offer of *group* medical insurance the IRS has offered three safe harbors for determining affordability: the W-2, rate of pay and federal poverty line safe harbors. The IRS anticipates it will allow these same safe harbors to apply when gauging whether the employee's portion of the premium payment cost for his individual market policy is affordable, net of his HRA benefit.

## What about minimum value?

Of course, the second tier of the ACA's employer mandate doesn't just require that an employee's coverage offer be affordable. The coverage must also supply minimum value (at least 60 percent actuarial value). The IRS says that any employee-purchased individual market policy considered affordable, net of the employer's HRA premium reimbursements, will automatically be considered minimum value, for purposes of the employer mandate's minimum value requirement.

*Lockton comment:* This makes sense because the affordability determination is based on the cost of the cheapest silver-level plan in the relevant ACA marketplace's rating area. Silver level coverage has an actuarial value of 70 percent, generally speaking.

## Next steps

Most employers offering group medical insurance will have little interest in premium reimbursement HRAs for a variety of reasons, particularly in a tight labor market. But some employers will have interest, and these employers must now await finalization of the proposed regulations resuscitating these HRAs, and issuance of the promised guidance related to the safe harbors mentioned above.

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