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Agencies Issue Affordable Care Act Guidance Making It Unlawful For Employers to Pay for an Employee's Individual Health Insurance Policy on a Tax-Free Basis

BY THE GLOBAL COMPENSATION, BENEFITS & ERISA PRACTICE GROUP

On September 13, 2013, the Internal Revenue Service and Department of Labor issued guidance[1] ("Notice") on how the Affordable Care Act ("ACA") applies to arrangements under which an employer reimburses an employee for all or a portion of the premium cost of an individual health insurance policy. Some employers have considered dropping their employee health coverage and instead subsidize employee purchases of individual insurance policies on the ACA exchange marketplace that will take affect this October.

The Notice generally provides that such an arrangement violates ACA's market reform rules unless the reimbursements are made on an after-tax basis and the arrangement qualifies for ERISA's payroll practice exemption. While not entirely clear, the Notice implies that another exemption from this prohibition is for balances of certain health reimbursement account ("HRAs") that were integrated with a group health plan and satisfy certain other requirements described in the Notice. The Notice also describes how the ACA's market reform rules apply to health FSAs that do not qualify as ACA-exempted benefits and to employee assistance programs ("EAPs"). The Notice is effective for plan years beginning on or after January 1, 2014.

Employer Payment Arrangements for Individual Policies

Employer-provided group health plans are subject to ACA's market reforms, including its prohibition on annual limits for essential benefits. Non-grandfathered plans are required to provide certain preventive services without imposing any cost-sharing requirements. Employers must self-report and pay excise taxes of $100 per day per each affected individual under Code Section 4980D for violations of ACA market reforms.

For over fifty years, the IRS has permitted employers to reimburse or otherwise pay for employee individual health insurance premiums on a tax-free basis.[2] With the ACA's exchange marketplace taking effect in October of this year, some employers have considered dropping their health coverage and subsidizing the cost of their employees' purchase of health coverage on the exchanges. Because all policies offered through the exchanges must comply with ACA's market reforms, an employer could

reasonably believe that such an arrangement should not be unlawful under the ACA because the policies themselves would be ACA compliant.

The DOL had previously stated that a stand-alone HRA (i.e., an HRA not integrated with an employer-provided group health plan) would violate ACA's annual limit prohibition.[3] The new Notice extends that prohibition to essentially all employer-provided arrangements that pay for individual health insurance premiums. The rationale is that the employer payment arrangement itself constitutes a group health plan subject to the ACA's market reform requirements and does not comply with the no-annual limit or preventive care requirements. Moreover, the Notice applies regardless of whether the individual insurance policy is purchased on an ACA exchange.

The Notice states that it does not apply to an employer giving an employee the choice between electing cash and an after-tax amount to be applied toward the purchase of an individual health insurance policy, and the employer's implementation of the latter choice would not constitute a group health plan subject to ACA's market reforms if it qualifies as a payroll practice under the DOL's ERISA regulations.[4]

The Notice provides that stand-alone HRAs maintained only for retirees are exempt from ACA's market reform rules and therefore may pay for individual health insurance premiums on a tax-free basis. However the Notice states retirees covered under such HRAs would be ineligible for any premium-tax credits that would otherwise be available to purchase such coverage through an ACA exchange marketplace[5]. While not expressly stated in the Notice, this exemption should also apply to employer payment arrangements for individual policies other than HRAs that are limited to retirees rather than employees.

Amplification of Integrated HRA Requirements

The Notice amplifies the requirements for an HRA to be considered integrated with an ACA-compliant group health plan so that the HRA will not violate the ACA's prohibition on annual limits for essential benefits. They are:

1. the employer offers a group health plan (other than an HRA) to the employee that does not consist solely of ACA excepted benefits;

2. the employee receiving the HRA is actually enrolled in a group health plan (other than the HRA) that does not consist solely of ACA excepted benefits (non-HRA group coverage), regardless of whether the employer sponsors the plan;

3. the HRA is available only to employees who are enrolled in the non-HRA group coverage, regardless of whether the employer sponsors the non-HRA group coverage;

4. the HRA is limited to reimbursement of one or more of the following: co-payments, co-insurance, deductibles, and the premiums under the non-HRA coverage, as well as Medicare care that does not constitute essential health benefits; and

5. the HRA permits the employee to permanently opt out and waive future HRA reimbursements at least annually and, on termination of employment, either the remaining amounts in the HRA are forfeited or the employee is permitted to permanently opt out of and waive future HRA reimbursements). The Notice provides this opt-out requirement is being imposed because HRA coverage will cause the participant to be ineligible for any

premium-tax credits that would otherwise be available to purchase coverage through an ACA exchange marketplace.

Alternatively, requirement number (4) above may be eliminated if the coverage under (1), (2) and (3) provides "minimum value" under the ACA.

If an employee is covered under an HRA integrated in accordance with the above requirements, the employee subsequently ceases to be covered under the group health plan that is integrated with the HRA, and the employee does not elect to opt out of the HRA coverage, the employee may obtain reimbursements through the unused amounts that were credited to the HRA while it was integrated without causing the HRA to violate ACA's market reforms. Presumably this would include permitting the employee to purchase individual health insurance policies. However, HRA coverage that is not limited to ACA excepted benefits would cause the employee to be ineligible for premium tax credits that would otherwise be available to purchase such coverage through the ACA exchange marketplace.

Application of ACA Market Reforms to EAPs and Non-Excepted Health FSAs

The Notice provides that EAPs are exempt from ACA's market reforms only if they do not provide significant benefits in the nature of medical care or treatment. Under the Notice, employers may use a reasonable, good faith interpretation of whether an EAP provides significant benefits in the nature of medical care or treatment.

The Notice provides that health FSAs that do not qualify as ACA-excepted benefits[6] are subject to ACA's market reforms, including the preventative services requirement. While interim final regulations exclude health FSAs from the annual limitation prohibition (even if they do not qualify as excepted benefits), the Notice states that the agencies will amend the regulations retroactive to September 14, 2013, to limit this relief to health FSAs that are offered under a Code Section 125 cafeteria plan (and thereby prevent stand-alone HRAs from qualifying for the relief).

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[1] Notice 2013-54; Tech. Rel. 2013-03.

[2] Rev. Rul. 61-146.

[3] Affordable Care Act Implementation FAQs Part IX, available at www.dol.gov/ebsa/healthreform.

[4] 29 C.F.R. § 2510.3-1(j).

[5] The Notice provides such a retiree is ineligible for premium tax credits because the HRA constitutes minimum essential coverage provided through an eligible employer sponsored plan. In addition, because the retiree is deemed enrolled in the HRA, the Notice states the affordability and minimum value requirements do not apply.

[6] A health FSA constitutes ACA excepted benefits if the maximum benefit payable to any participant cannot exceed two times the participant's salary reduction or, if greater, $500 plus the amount of the participant's salary reduction election.