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New Guidance for Health FSAs and HRAs – Review Your Plans Now

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By Compensation Planning & Employee Benefits Group

Recent guidance issued by the IRS and DOL may affect the design and structure of some of your benefits arrangements. The new guidance relates to the application of certain Affordable Care Act (ACA) provisions to health reimbursement arrangements (HRAs) and other medical reimbursement plans. In addition, the IRS has provided another exception to the "use-it-or-lose-it" rule for health flexible spending accounts (health FSAs).

Background

On September 13, 2013, the U.S. Departments of Treasury and Labor issued Notice 2013-54 and DOL Technical Release 2013-03, respectively, both effective January 1, 2014. The new guidance prevents employers from providing pre-tax arrangements to fund the payment of individual health insurance premiums and restricts participation in HRAs to those employees who are enrolled in a group health plan. In general, the guidance is based on the ACA's prohibition of annual dollar limits on essential health benefits and the requirement to provide first-dollar coverage for preventive services. Failure to comply with these provisions will result in an excise tax assessed against the employer of $100 per day per affected individual.

Further, on October 31, 2013, the IRS issued Notice 2013-71, which modified the "use-it-or-lose-it" rule by allowing employers to amend their cafeteria plans to carry over up to $500 of unused funds in an employee's health FSA.

Health Reimbursement Accounts

Premium Reimbursement Accounts. In the past, some employers, particularly smaller employers, helped employees purchase medical coverage by reimbursing them on a pre-tax basis for premiums paid for an individual health insurance policy. Effective January 1, 2014, pre-tax premium reimbursement arrangements are no longer allowed. Employers may reimburse employees on an after-tax basis and voluntary employee-pay-all arrangements are still allowed.

"Integrated" HRAs. Effective January 1, 2014, only HRAs that are "integrated" with a group health plan that complies with the ACA requirements will be permitted. HRAs *cannot* be integrated with individual health insurance policies or coverage through the health care exchange.

An HRA is "integrated" with a group health plan if it meets one of two alternatives (described below); however, the HRA and the group health plan with which it is integrated need not be sponsored by the same employer, be governed by the same plan document or be included on the same Form 5500.

An HRA can be integrated with a group health plan under two integration methods. Each method requires that the following conditions be met:

- The employer must offer a group health plan other than the HRA.
- The employee must actually be enrolled in another group health plan.
- The HRA can be made available only to employees who are enrolled in another group health plan.
- At least annually, the employee may permanently opt out of the HRA.
- Upon termination of employment, any amounts remaining in the HRA must be forfeited, or the employee can permanently opt out and waive any future reimbursements.

The primary differences between the two integration methods are whether the other group health plan offers minimum value and the types of reimbursement expenses that are allowed. If the other group health plan *does not* provide minimum value, the HRA can only reimburse co-pays, deductibles, co-insurance, premiums and other medical benefits that are not "essential health benefits." If the other group health plan *does* provide minimum value, the HRA reimbursements are not limited to these types of expenses.

If the employee ceases to be covered by the group health plan with which the HRA is integrated, that employee is no longer eligible to receive new contributions to the HRA; however amounts that were credited to the HRA while it was integrated with the other group health plan may be used for future reimbursements. Furthermore, under certain conditions unused amounts credited to an HRA prior to January 1, 2014, may continue to be used to reimburse medical expenses in accordance with the terms of that HRA.

Currently, it appears that the following arrangements are still permissible:

- An HRA that limits reimbursements to dental and vision benefits, disability income and long-term care benefits.
- Health FSAs offered as part of a cafeteria plan that constitute "excepted benefits," which generally means that the following conditions must be met: (i) the employer must provide other group health coverage, and (ii) the employer's contribution to the health FSA cannot exceed the employee's salary reductions

(or, if greater, $500).

- Retiree-only HRAs.
- Employee assistance programs (EAPs), so long as the program does not provide "significant" medical benefits.

Health Flexible Spending Accounts

New IRS guidance provides a new exception to the "use-it-or-lose-it" rule for health FSAs, allowing a carryover of up to $500 of unused health FSA funds from year to year. Originally if a participant did not incur medical expenses during the plan year in an amount equal to his/her health FSA contributions, the law required that the unused funds be forfeited under the "use-it-or-lose-it" rule. Guidance in 2005 provided that the health FSA could be amended to provide a 2½-month grace period following the end of the plan year, during which the employee could incur medical expenses and receive reimbursement from amounts deducted in the prior year. Now employers can choose to provide for a carryover of up to $500 of unused health FSA funds.

The amount of the carryover is limited to $500 per employee and does not reduce the maximum amount that the employee can elect to contribute in the following year. For example, if an employee has a $500 carryover from their 2013 plan year balance, the employee can elect to contribute $2,500 to his/her health FSA for the 2014 plan year, resulting in a $3,000 health FSA balance available to reimburse medical expenses incurred during the 2014 plan year.

However, the employer cannot offer both the carryover *and* the 2½-month grace period. Thus employers who wish to include an exception to the "use-it-or-lose-it" rule must make a choice —either provide for the $500 carryover *or* the 2-½ grace period. If the employer chooses to use the carryover, the cafeteria plan document must be amended to reflect this change by December 31, 2014 and the provision must be applied uniformly to all plan participants.

Next Steps

In the next few weeks, employers need to carefully review their health care reimbursement plans, medical expense reimbursement plans, cafeteria plans and similar reimbursement arrangements. Specifically:

- If the employer offers a pre-tax reimbursement of individual health insurance policies, the employer will want to consider whether to provide that reimbursement on an after-tax basis.
- HRAs and other medical expense reimbursement plans may need to be amended to ensure that they are "integrated" with a group health plan.
- Health FSAs should be reviewed to ensure that they meet the requirements for "excepted benefits."

- Employers should evaluate whether to use the $500 carryover or the 2-½-month grace period for their health FSAs. If the employer currently uses the 2-½ month grace period, the employer should carefully consider the effect that switching to the $500 carryover may have on employees, and the timing of implementing that change.

Please contact a member of the Compensation Planning & Employee Benefits Group of Fredrikson & Byron should you have any questions or if you would like assistance with implementing these new rules.

Debra J. Linder
Direct Dial: 612.492.7163
Email: dlinder@fredlaw.com