ACA COMPLIANCE BULLETIN

IRS Issues Final Rule on Pay or Play and Nondiscrimination Rules for ICHRAs

Since 2020, employers have been able to offer individual coverage HRAs (ICHRAs) to help employees pay for individual health insurance. ICHRAs were established by a final rule published on June 20, 2019, which raised questions about how existing federal rules will apply to ICHRAs.

On Jan. 13, 2021, the IRS issued a final rule to clarify the application of the following federal requirements to ICHRAs:

- The Section 4980H employer shared responsibility (pay or play) rules under the Affordable Care Act (ACA); and
- The federal nondiscrimination requirements in Internal Revenue Code (Code) Section 105(h).

The final rule affects employers, employees and their family members, plan sponsors, and health insurance issuers that offer individual health insurance coverage. This Compliance Bulletin provides an overview of the provisions in the final rule.

Action Steps

Employers that offer coverage under an ICHRA should review their plans to ensure that they are consistent with the final rule to avoid unexpected liability under the pay or play or nondiscrimination rules. Employers that are considering implementing an ICHRA can use the final rule as guidance in establishing their plans.

Highlights

- If certain requirements are met, offering an ICHRA will generally satisfy an employer's pay or play obligations.
- ALEs may use the affordability safe harbors to determine affordability for an ICHRA.
- The final rule provides information on specific plan designs that will comply with the Code section 105(h) nondiscrimination rules.

Important Dates

Jan. 13, 2021
The final rule was issued.

Jan. 1, 2020
The provisions in the final rule generally apply to plan years beginning in 2020. However, taxpayers may rely on the provisions in the proposed rule until plan years beginning six months following publication of the final rule.

Provided to you by **New England Employee Benefits Co., Inc.**

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Background

Beginning in 2020, HRAs may be integrated with individual insurance coverage through use of an individual coverage HRA (ICHRA) for purposes of compliance with the ACA, eliminating the existing prohibition on this type of arrangement. **This means that HRAs may be used to reimburse employees for the cost of individual health coverage on a tax-preferred basis**, if certain conditions are met.

On Nov. 19, 2018, the IRS issued Notice 2018-88 to begin developing guidance on the impact of the proposed HRA rule on the ACA's employer shared responsibility rules and the Code Section 105(h) federal nondiscrimination requirements. Separate IRS final rules were also issued regarding premium tax credit eligibility for individuals offered coverage under an HRA integrated with individual health insurance coverage (PTC rules). Generally, an individual who is covered by an HRA integrated with individual health coverage is ineligible for the premium tax credit.

Under the final PTC rules, an ICHRA is considered to be affordable for a month if the employee's required HRA contribution for the month does not exceed 1⁄12 of the product of the employee's household income for the taxable year and the required contribution percentage. The required HRA contribution is the excess of:

- The monthly premium for the lowest-cost silver plan for self-only coverage of the employee offered in the Exchange for the rating area in which the employee resides (the PTC affordability plan); over
- In general, the self-only amount the employer makes newly available to the employee under the ICHRA for the month (the monthly HRA amount).

Under the final PTC rules, an ICHRA that is affordable is treated as providing minimum value. The final PTC rules apply for taxable years beginning on or after Jan. 1, 2020.

Application of the Employer Shared Responsibility Rules to ICHRAs

The ACA's employer shared responsibility rules require applicable large employers (ALEs) to offer minimum essential coverage (MEC) that is affordable and provides minimum value to their full-time employees, or pay a penalty. The final rule addresses the application of the employer shared responsibility rules to ICHRAs.

> Note that these rules do not apply to employers that are not ALEs, or in situations where ALEs offer an ICHRA to part-time employees. Employers that are not ALEs or that offer an ICHRA only to part-time employees do not need to consider affordability of the offer of ICHRA coverage under these rules.

Specifically, the final rule provides that **an HRA, including an ICHRA, qualifies as an eligible employer-sponsored plan**. Therefore, an ALE that offers MEC, which may include an ICHRA, to at least 95% of its full-time employees (and their dependents) would not be liable for a Section 4980H(a) penalty for the month, regardless of whether any full-time employee received an Exchange subsidy.

In addition, for purposes of the Section 4980H(b) penalty, the final rule provides that:

- An ALE offering an ICHRA to a class of employees may use the pay or play rules' affordability safe harbors in determining whether the offer of the ICHRA is affordable for purposes of the Section 4980H(b) penalty. In applying the affordability safe harbors to an offer of an ICHRA, the employee's required HRA contribution is to be used, taking into account any other applicable safe harbors under the final rule. For this purpose, the employee's "required HRA contribution" generally is the excess of the premium for self-only coverage under

the lowest-cost silver plan offered in the rating area where the employee resides, over the self-only amount the employer makes newly available to the employee under the ICHRA.

- An ICHRA that is affordable for purposes of the pay or play rules is deemed to provide minimum value.

The final rule provides the following safe harbors to simplify the determination of the applicable lowest-cost premium for ALEs:

- A safe harbor that allows ALEs to use a look-back month before the plan year; and
- A safe harbor that allows ALEs to use employees' primary worksite, rather than their residence.

Application to the Section 6055 and Section 6056 Reporting Requirements

Section 6056

Section 6056 requires ALEs to file with the IRS and furnish to full-time employees information about whether the employer offers coverage to full-time employees and, if so, information about the coverage offered. **An ALE that offers an ICHRA to its full-time employees is required to satisfy the Section 6056 reporting requirements**. ALEs use Form 1094-C and Form 1095-C to satisfy the section 6056 reporting requirements.

The final regulations specifically decline to provide guidance on Section 6056 reporting with respect to ICHRAs. Instead, additional administrative guidance, including forms and instructions, regarding reporting in connection with ICHRAs has been provided.

The 2020 Form 1095-C and related instructions allow the employee's required contribution to be reported based on the Section 4980H safe harbor(s) used by the ALE, rather than the employee's required contribution determined under the final PTC regulations without application of the relevant safe harbors. The 2020 Form 1095-C also includes revised codes to account for the new ICHRA safe harbors. The IRS notes that, while the 2020 Form 1095-C requests an employee's age as of Jan. 1, 2020, for purposes of administrative simplicity, the related instructions clarify that, for non-calendar year plans or for employees who become eligible during the plan year, this age may not be the applicable age used to determine the employee's required contribution based on the final regulations.

Section 6055

Section 6055 requires all entities that provide minimum essential coverage (MEC) to an individual to report certain information to the IRS that identifies covered individuals and the period of coverage, and to furnish a statement to the covered individuals including the same information. Information returns under Section 6055 generally are filed using Form 1094-B and Form 1095-B. However, self-insured ALEs are required to file Form 1095-C and use Part III of that form, rather than Form 1095-B, to report information required under Section 6055.

ICHRAs are group health plans and, therefore, are considered MEC. Accordingly, **reporting under Section 6055 is required for ICHRAs**. In general, the employer is the entity responsible for this reporting. Exceptions apply for certain duplicative coverage or supplemental coverage providing MEC. **However, these exceptions generally do not apply to ICHRAs**.

Section 105(h) Nondiscrimination Requirements

Code Section 105(h) contains nondiscrimination rules prohibiting self-insured health plans from discriminating in favor of highly compensated individuals (HCIs) with respect to eligibility or benefits. The **eligibility test** looks at whether a sufficient

number of non-HCIs benefit under a self-insured health plan, and the **benefits test** analyzes whether the plan provides HCIs with better benefits.

The benefits test includes a uniformity requirement that any maximum reimbursement limit attributable to employer contributions be uniform for all participants, and not vary based on a participant's age or years of service. If a plan fails the benefits test, benefits provided under the discriminatory plan will be taxable to the HCI.

A previous HRA final rule allows a plan sponsor to:

- Limit the offer of the ICHRA to certain classes of employees and to vary the amounts, terms and conditions of individual coverage HRAs between the different classes of employees. However, within each class of employees, the plan sponsor would be required to offer the ICHRA on the same terms and conditions (including, generally, in the same amount) to all employees who are members of that class; and
- Increase the maximum dollar amount made available to an employee for any plan year as the age of the employee increases (provided the same maximum dollar amount attributable to the increase in an employee's age is made available to all employees who are members of the same class of employees who are the same age).

To facilitate offering ICHRAs, the final rule provides that a covered HRA meets the uniformity requirement if it:

- **Provides the same maximum dollar amount to all employees who are members of a particular class of employees**, limited to the following classes specified in the HRA final rule: full-time employees, using either the Section 105(h) or 4980H definition; part-time employees, using either the Section 105(h) or 4980H definition; seasonal employees, using either the Section 105(h) or 4980H definition; employees covered by a collective bargaining agreement; employees who have not satisfied an ACA-compliant waiting period for coverage; employees who have not attained age 25 prior to the beginning of the plan year; foreign employees who work abroad; and employees whose primary site of employment is in the same rating area; and
- **Increases the maximum dollar amount made available to members of a particular class of employees in accordance with the increases in the price of an individual health insurance policy based on the ages of the members of that class**, provided that the same maximum dollar amount attributable to the age increase is made available to all members of that class of employees who are the same age.

The final rule notes that **satisfying the terms of these safe harbors does not automatically satisfy the requirement that the ICHRA be nondiscriminatory in operation**. Therefore, among other situations, if a disproportionate number of HCIs qualify for and utilize the maximum HRA amount allowed under the same terms requirement based on age in comparison to the number of non-HCIs who qualify for and use lower HRA amounts based on age, the ICHRA may be found to be discriminatory. This means that excess reimbursements of the HCIs will be included in their income.

Application of Section 125 Cafeteria Plan Rules to ICHRAs

Some employers may want to allow employees to pay the portion of the premium for individual health coverage that is not covered by an ICHRA, if any, through a salary reduction arrangement under a Section 125 cafeteria plan. Existing rules generally prohibit an employer from providing a qualified health plan (QHP) purchased through an Exchange as a benefit under its cafeteria plan. Therefore, an employer may not allow employees to make salary reduction contributions to a cafeteria plan to purchase a QHP (including individual health coverage) offered through an Exchange.

However, this rule does not apply to individual health coverage that is not offered through an Exchange. Therefore, **for an employee who purchases off-Exchange individual health coverage, the employer may allow the employee to pay the balance of the premium for the coverage through its cafeteria plan**. The IRS continues to consider specific issues raised by the application of the Section 125 cafeteria plan rules to arrangements involving ICHRAs for which clarification is needed or for which a modification of the applicable rules may decrease burdens.