New HRA Rules Might Not Be Useful for Some Employers

by Stephanie Cumings

New proposed regulations are meant to facilitate the use of a new kind of health reimbursement arrangement by using safe harbors to help employers avoid penalties, but the rules may not be that helpful to some.

The proposed regs (REG-136401-18) issued September 27 build off of safe harbors introduced in Notice 2018-88, 2018-49 IRB 817, that deal with the affordability of newly created individual coverage HRAs. The IRS finalized rules (T.D. 9867) on individual coverage HRAs in June.

The new proposed regs will likely be of limited use to employers with older workforces, Andy R. Anderson of Morgan, Lewis & Bockius LLP told *Tax Notes*.

That's because affordability is tied to the employee's age, Anderson said, which means it could cost an employer significantly more to satisfy the affordability requirement for an older employee than the penalty that would otherwise result.

> ***The absence of an age-based safe harbor means the rules are 'financially unworkable' for most employers, Anderson said.***

The IRS received comments asking for a safe harbor on employee age, and it acknowledged that "determining the premium for the affordability plan for each employee based on his or her age might be burdensome for some employers."

But the IRS ultimately refused to provide an age-based safe harbor because it would "likely result in a number of employees (those with an age greater than the safe harbor age) receiving the [premium tax credit] while the employer would not be subject to an employer shared responsibility payment under section 4980H(b), including in some cases by employer design."

Anderson said the absence of an age-based safe harbor means the rules are "financially unworkable" for most employers. He said there are other complications in the regs, but they pale in comparison to what an employer with older workers would have to spend to make its HRAs affordable.

Still, Anderson added that there will be employers in low-cost areas with younger employees for whom the regs could be a good opportunity.

Location-Based Safe Harbor

The new regs propose a safe harbor based on the employee's primary site of employment.

The IRS said it received numerous comments asking for something more expansive, but it refused to go further. It said the proposals in the comments could lead to "a significant number of cases in which one or more of an [employer's] full-time employees are allowed the [premium tax credit] while the [employer] is treated as providing those full-time employees affordable coverage, with the result that the [employer] is not liable for an employer shared responsibility payment."

Employers are liable for the section 4980H(b) penalty if the coverage offered isn't affordable, which is triggered by employees claiming a premium tax credit, but affordability depends on where the employee is located and the price of plans available in that area.

The IRS said that a location-based safe harbor centered on place of employment was necessary because "employees' places of residence might change with some frequency, and it could be difficult for employers to keep their records up to date."

"The Treasury Department and the IRS recognize that a safe harbor based on the employee's primary site of employment could raise similar issues of avoidance of the employer shared responsibility payment, but it would be on a much more limited scale," according to the regs.

The IRS said it's likely that "many employees live in relatively close proximity to where they work," so work location is a reasonable proxy for residence.

However, the IRS also asked for comments on "other methods of determining affordability under section 4980H that would not result in significant discrepancies."

The proposed rules detail how to determine an employee's primary site of employment, including special rules for teleworkers. The IRS

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asked for comments on this as well given that "the manner in which employees report to work varies widely across employers and industries."

Lookback Period and Nondiscrimination

The regs also include a lookback safe harbor that allows employers to use premium information from the prior year to determine affordability.

Employers offering an individual coverage HRA with a calendar-year plan year can use the monthly premium for January of the prior calendar year. The proposed regs don't include any adjustments to the prior premium information, and the IRS has asked for comments on whether an adjustment is warranted.

The regs also provide that employers can use the household income safe harbors in determining whether an HRA is affordable.

Anderson said he was happy to see that under the regs, employers generally won't encounter problems with the section 105(h) nondiscrimination rules if they abide by the safe harbor rules. He noted that some of the section 105 rules are out of date and predicted that the new HRA regs could foreshadow broader changes to the nondiscrimination rules in the future.

Regarding section 105(h), the preamble to the regs notes that "if a disproportionate number of [highly compensated individuals] qualify for and utilize the maximum HRA amount allowed under the same terms requirement based on age in comparison to the number of [non-highly compensated individuals] who qualify for and use lower HRA amounts based on age, the individual coverage HRA may be found to be discriminatory, with the result that excess reimbursements of the [highly compensated individuals] will be included in their income." ■

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