

# Current Federal Tax Developments

Week of June 16, 2019

Edward K. Zollars, CPA  
(Licensed in Arizona)

ACCOUNTING  
CONTINUING EDUCATION

CURRENT FEDERAL TAX DEVELOPMENTS  
WEEK OF JUNE 16, 2019  
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Published in 2019 by Kaplan Financial Education.

Printed in the United States of America.

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# Current Federal Tax Developments

Kaplan Financial Education

## Table of Contents

Section: Security Transcripts Will No Longer Be Sent Via Fax, Nor Will They Be Mailed Other Than to Taxpayer's Address of Record, After June 28, 2019.....	1
Citation: "IRS takes additional steps to protect taxpayer data; plans to end faxing and third- party mailings of certain tax transcripts," IR-2019-101, 6/4/19.....	1
Section: 170 IRS Finalizes Regulations Requiring Reduction of Charitable Contribution Deduction by Related State Income Tax Credits in Excess of 15% of the Contribution.....	3
Citation: TD 9864, Notice 2019-12, 6/11/19.....	3
Section: 9831 Regulations Issued Creating Individual Coverage HRA and Excepted Benefit HRAs.....	7
Citation: TD 9867, 6/13/19 .....	7
Individual Coverage HRA .....	7
Class of Employees .....	8
Former Employees .....	9
Entry After Beginning of Plan Year .....	10
Allowed Classes of Employees.....	11
Minimum Class Size Rule.....	15
New Hire Dates .....	22
Opt-Out Rule .....	26
Substantiation Requirements .....	26
Model Substantiation Documents.....	27
Reliance on Substantiation .....	29
Written Notice to Participants.....	29
Timing of Notice to Participants .....	30
Special Insurance Type Issues .....	31
Individual Coverage HRA and Health Savings Accounts (HSAs) .....	32
Medicare Integration and Issues.....	32
Amounts Made Available Via Individual Coverage HRA.....	33
Excepted Benefit HRAs .....	34

Individual Coverage HRAs and Excepted Benefit HRAs ..... 36

## Section: Security

### Transcripts Will No Longer Be Sent Via Fax, Nor Will They Be Mailed Other Than to Taxpayer's Address of Record, After June 28, 2019

Citation: "IRS takes additional steps to protect taxpayer data; plans to end faxing and third-party mailings of certain tax transcripts," IR-2019-101, 6/4/19

The IRS has announced in a news release that on June 28 the agency will no longer fax or mail transcripts to third parties under steps announced to attempt to protect taxpayer data from unauthorized release.<sup>1</sup> The IRS had warned in 2018 that they planned to take this step.

The news release explains the issues raised by the prior system of faxing or mailing transcripts to third parties:

*Tax transcripts are summaries of tax return information. Transcripts have become increasingly vulnerable as criminals impersonate taxpayers or authorized third parties. Identity thieves use tax transcripts to file fraudulent returns for refunds that are difficult to detect because they mirror a legitimate tax return.<sup>2</sup>*

The issue with prior systems is one we've discussed before here in dealing with information system security—the paper system for authorizing such releases did not provide adequate *authentication*. Authentication involves processes to insure that the party to which data is being provided or access is granted is actually the party who should be granted access to such information.

The faxing program ends on June 28. The news release provides mechanisms that taxpayers who previously would ask to have a transcript faxed to him/her can now use to access transcripts:

*Individual taxpayers have several options to obtain a tax transcript. They may:*

- *Use IRS.gov or the IRS2Go app to access Get Transcript Online; after verifying their identities, taxpayers may immediately download or print their transcript, or*
- *Use IRS.gov or the IRS2Go app to access Get Transcript by Mail; transcript will be delivered within 10 days to the address of record, or*
- *Call 800-908-9946 for an automated Get Transcript by Mail feature, or*
- *Submit Form 4506-T or 4506T-EZ to have a transcript mailed to the address of record.*

Observers will note that the last two options seems to have limited authentication systems built in. The IRS is relying on the fact that the transcript is being sent to the taxpayer's last known address and, presumably, even if the transcript isn't being requested by the taxpayer they will still be the one to receive the transcript.

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<sup>1</sup> IR 2019-101, June 4, 2019, <https://www.irs.gov/newsroom/irs-takes-additional-steps-to-protect-taxpayer-data-plans-to-end-faxing-and-third-party-mailings-of-certain-tax-transcripts>, site accessed June 10, 2019

<sup>2</sup> *Ibid*

## 2 Current Federal Tax Developments

Obviously that system is not fool proof—no authentication is necessary to file a change of address form with the IRS (which would change the address of record), nor will this system work to stop a party that has access to the taxpayer’s mail (such as a member of the same household) from obtaining the data. But as is generally true, the agency has to balance security against the need to serve taxpayers who aren’t able or willing to use more secure means of accessing the data.

The news release also provides options for tax professionals to obtain transcript information once the faxing and third-party mailing program ends:

*Tax professionals also have several options to obtain tax transcripts necessary for tax preparation or representation as follows:*

- *Request that the IRS mail a transcript to the taxpayer’s address of record, or*
- *Use e-Services’ Transcript Delivery System online to obtain masked individual transcripts and business transcripts, or*
- *Obtain a masked individual transcript or a business transcript by calling the IRS, faxing authorization to the IRS assistor and the IRS assistor will place the document in the tax practitioner’s e-Services secure mailbox.*
- *When needed for tax preparation purposes, tax practitioners may:*
  - *Obtain an unmasked wage and income transcript by calling the IRS, faxing authorization to the IRS assistor and the IRS assistor will place the document in the tax practitioner’s e-Services secure mailbox, or*
  - *Obtain an unmasked wage and income transcript if authorization is already on file by using e-Service’s Transcript Delivery System.*

The release notes that taxpayers will no longer be able to use Forms 4506, 4506-T or 4506-EZ to request that transcripts be sent to third-parties and the form will be modified to remove that option. The release notes that lenders often have used these documents to verify income and that tax preparers are often the parties listed to receive these documents.

Per the release, taxpayers will still be able to use these forms to request that transcripts and copies of returns be sent to their address and that the program will not affect the use of the data retrieval tool through the Free Application for Federal Student Aid (FAFSA) process.

The release goes on to describe other options available for parties that previously relied on having these documents mailed direct to them:

*Third parties who use these forms for income verification have other alternatives. The IRS offers an Income Verification Express Service (IVES) which has several hundred participants, who, with proper authorization, order transcripts. Lenders or higher education institutions can either contract with existing IVES participants or become IVES participants themselves. The tax transcript is an official IRS record. Taxpayers may choose to provide transcripts to requestors instead of authorizing the third party to request these transcripts from the IRS on their behalf.*

*Tax professionals who are attorneys, Certified Public Accountants or Enrolled Agents (i.e., Circular 230 practitioners) and do not have an e-Services account may create one and, with proper authorization from clients, can access the e-Services’ Transcript Delivery System. Unenrolled tax practitioners must have an e-File application on file and be listed as delegated users to access TDS.*

The release also notes the IRS will provide a “customer file number” space on returns since the taxpayer’s name and social security number will now be partially masked. This number will allow a third party to assign such a customer number to a taxpayer which will allow that party to match up the documents (which will have the customer account number printed on them) to the specific individual involved.<sup>3</sup>

**Section: 170**  
**IRS Finalizes Regulations Requiring Reduction of Charitable Contribution Deduction by Related State Income Tax Credits in Excess of 15% of the Contribution**

Citation: TD 9864, Notice 2019-12, 6/11/19

The IRS has issued final regulations under §170 to deal with state tax credits that reduce state income taxes in exchange for certain charitable contributions (TD 9864).<sup>4</sup> While the IRS received a number of comments on the regulations, the final regulations generally adopt without change the proposed regulations issued in the summer of 2018.

Under these regulations, a taxpayer who makes a contribution to a charity for which he/she receives a tax credit against state income taxes in excess of 15% of the amount contributed must reduce the amount of the charitable contribution claimed by the amount of the credit.<sup>5</sup> The amount of the reduction is the maximum amount of the credit allowable for the amount of the contribution made by the taxpayer.<sup>6</sup>

***EXAMPLE FROM REGULATIONS***

*(A) Example 1. A, an individual, makes a payment of \$1,000 to X, an entity described in section 170(c). In exchange for the payment, A receives or expects to receive a state tax credit of 70 percent of the amount of A’s payment to X. Under paragraph (b)(3)(i) of this section, A’s charitable contribution deduction is reduced by \$700 ( $0.70 \times \$1,000$ ). This reduction occurs regardless of whether A is able to claim the state tax credit in that year. Thus, A’s charitable contribution deduction for the \$1,000 payment to X may not exceed \$300.*

*(B) Example 2. B, an individual, transfers a painting to Y, an entity described in section 170(c). At the time of the transfer, the painting has a fair market value of \$100,000. In exchange for the painting, B receives or expects to receive a state tax credit equal to 10 percent of the fair market value of the painting. Under paragraph (b)(3)(vi) of this section, B is not required to apply the general rule of paragraph (b)(3)(i) of this section because the amount of the tax credit received or expected to be received by B does not exceed 15 percent of the fair market value of the property transferred to Y. Accordingly,*

<sup>3</sup> *Ibid*

<sup>4</sup> TD 9864, <https://s3.amazonaws.com/public-inspection.federalregister.gov/2019-12418.pdf>, retrieved on June 11, 2019

<sup>5</sup> Reg. §1.170A-1(h)(3)(i) and (vi)

<sup>6</sup> Reg. §1.170A-1(h)(3)(iv)

## 4 Current Federal Tax Developments

*the amount of B's charitable contribution deduction for the transfer of the painting is not reduced under paragraph (b)(3)(i) of this section.<sup>7</sup>*

\*\*\*\*\*

A taxpayer receiving only a deduction against taxable income for state income tax purposes is not required to reduce his/her charitable contribution deduction unless that deduction is an *excess state or local tax deduction*.<sup>8</sup> An *excess state or local deduction* is a deduction given to the taxpayer by the state that exceeds the taxpayer's payment or the fair market value of the property.<sup>9</sup>

### **EXAMPLE FROM REGULATIONS**

*(C) Example 3. C, an individual, makes a payment of \$1,000 to Z, an entity described in section 170(c). In exchange for the payment, under state M law, C is entitled to receive a state tax deduction equal to the amount paid by C to Z. Under paragraph (b)(3)(ii)(A) of this section, C's charitable contribution deduction under section 170(a) is not required to be reduced on account of C's state tax deduction for C's payment to Z.*

\*\*\*\*\*

The reduction rules also apply to charitable contribution deductions under IRC §642(c) for an estate or trust.<sup>10</sup>

The IRS did take note of comments received that the proposed regulations' requirement to reduce the charitable contributions did have a negative impact on taxpayers who itemized deductions and did not have state and local tax deductions in excess of \$10,000. These taxpayers would face a higher tax than that would otherwise face if they made a tax credit contribution that reduced their state and local tax deduction and for which they received no corresponding charitable contribution.

### **EXAMPLE**

*LeAnn, before making a contribution to a school tuition organization for which the state will offer a 100% state tax credit on contributions up to \$1,000, expects to have total state and local deductions on her 2019 Schedule A of \$8,000, which includes estimated state income tax payments equal to her expected liability. LeAnn itemizes her deductions for 2019.*

*Assume LeAnn, deciding to make that contribution, reduces her state tax estimated tax payment by the \$1,000 credit she now expects to receive due to making a \$1,000 contribution. LeAnn's itemized deductions and taxable income will increase by \$1,000 as she loses the \$1,000 state income tax*

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<sup>7</sup> Reg. §1.170A-1(h)(3)(vii)(A) and (B)

<sup>8</sup> Reg. §1.170A-1(h)(3)(ii)(A)

<sup>9</sup> Reg. §1.170A-1(h)(3)(ii)(B)

<sup>10</sup> Reg. §1.642(c)-3(g)



*deduction she would have received on the estimated tax payment but does not receive a corresponding income tax deduction once Reg. §1.170A-1(b)(3)'s rules are applied to her contribution.*

\*\*\*\*\*

The IRS responded to this concern by issuing Notice 2019-12<sup>11</sup> at the same time as the final regulations. The notice provides that the IRS plans to issue proposed regulations under §164 (the deduction for state and local taxes) to amend Reg. §1.164-3 to allow certain taxpayers to elect to treat the *quid pro quo* payment received for the charitable contribution as a payment of state and local taxes.<sup>12</sup>

*Under this safe harbor, an individual who itemizes deductions and who makes a payment to a section 170(c) entity in return for a state or local tax credit may treat as a payment of state or local tax for purposes of section 164 the portion of such payment for which a charitable contribution deduction under section 170 is or will be disallowed under final regulations. This treatment as a payment of state or local tax under section 164 is allowed in the taxable year in which the payment is made to the extent the resulting credit is applied, consistent with applicable state or local law, to offset the individual's state or local tax liability for such taxable year or the preceding taxable year. To the extent the resulting credit is not applied to offset the individual's state or local tax liability for the taxable year of the payment or the preceding taxable year, any excess credit permitted to be carried forward may be treated as a payment of state or local tax under section 164 in the taxable year or years for which the carryover credit is applied, consistent with applicable state or local law, to offset the individual's state or local tax liability. This safe harbor shall not apply to a transfer of property.<sup>13</sup>*

The notice provides that the safe harbor found in the notice does not permit the taxpayer to claim the deduction under more than one Code section, nor can it be used to allow a taxpayer to avoid the \$10,000 state and local tax deduction limitation found in IRC §164(b)(6).<sup>14</sup>

The notice provides the following examples of applying the safe harbor.

#### **EXAMPLES FROM NOTICE 2019-12**

*Example 1. In year 1, Taxpayer A makes a payment of \$500 to an entity described in section 170(c). In return for the payment, A receives a dollar-for-dollar state income tax credit. Prior to application of the credit, A's state income tax liability for year 1 was \$500 or more; A applies the \$500 credit to A's year 1 state income tax liability. Under section 3 of this notice, A treats the \$500 payment as a payment of state income tax in year 1 for purposes of section 164. To determine A's deduction amount, A must apply the provisions of section 164 applicable to payments of state and local taxes, including the limitation under section 164(b)(6).*

*Example 2. In year 1, Taxpayer B makes a payment of \$7,000 to an entity described in section 170(c). In return for the payment, B receives a dollar-for-dollar state income tax credit, which under*

<sup>11</sup> Notice 2019-12, <https://www.irs.gov/pub/irs-drop/n-19-12.pdf>, retrieved on June 11, 2019

<sup>12</sup> *Ibid*, p. 6

<sup>13</sup> *Ibid*

<sup>14</sup> *Ibid*, pp. 6-7

## 6 Current Federal Tax Developments

*state law may be carried forward for three taxable years. Prior to application of the credit, B's state income tax liability for year 1 was \$5,000; B applies \$5,000 of the \$7,000 credit to B's year 1 state income tax liability. Under section 3 of this notice, B treats \$5,000 of the \$7,000 payment as a payment of state income tax in year 1 for purposes of section 164. Prior to application of the remaining credit, B's state income tax liability for year 2 exceeds \$2,000; B applies the excess credit of \$2,000 to B's year 2 state income tax liability. For year 2, B treats the \$2,000 as a payment of state income tax for purposes of section 164. To determine B's deduction amounts in years 1 and 2, B must apply the provisions of section 164 applicable to payments of state and local taxes, including the limitation under section 164(b)(6)*

*Example 3. In year 1, Taxpayer C makes a payment of \$7,000 to an entity described in section 170(c). In return for the payment, C receives a local real property tax credit equal to 25 percent of the amount of this payment (\$1,750). Prior to application of the credit, C's local real property tax liability in year 1 was \$3,500; C applies the \$1,750 credit to C's year 1 local real property tax liability. Under section 3 of this notice, for year 1, C treats \$1,750 as a payment of local real property tax for purposes of section 164. To determine C's deduction amount, C must apply the provisions of section 164 applicable to payments of state and local taxes, including the limitation under section 164(b)(6).*

\*\*\*\*\*

The safe harbor applies to payments made for such charitable contributions after August 27, 2018.<sup>15</sup> Note that some taxpayer who followed the proposed regulations in preparing their 2018 income tax returns may wish to amend their returns to take advantage of the safe harbor for any post-August 27, 2018 contributions.

The IRS rejected most other recommendations received in comments, including requests to exempt programs that were in effect prior to the enactment of the Tax Cuts and Job Act's new limitation on state and local tax deductions from the reduction. The IRS gave the following reason for rejecting the request:

*The regulations are based on longstanding federal tax law principles that apply equally to all taxpayers. To ensure fair and consistent treatment, the final regulations do not distinguish between taxpayers who make transfers to state and local tax credit programs enacted after the Act and those who make transfers to tax credit programs existing prior to the enactment of the Act. Neither the intent of the section 170(c) organization, nor the date of enactment of a particular state tax credit program, are relevant to the application of the quid pro quo principle. Accordingly, the final regulations apply the rules equally to all state and local tax credit programs, and the final regulations do not adopt commenter recommendations to create exceptions to the general rule for various types of state tax credit programs.<sup>16</sup>*

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<sup>15</sup> *Ibid*, p. 8

<sup>16</sup> TD 9864, <https://s3.amazonaws.com/public-inspection.federalregister.gov/2019-12418.pdf>, retrieved on June 11, 2019, pp. 39-40

The regulations are scheduled to take effect 60 days after they are published in the *Federal Register*.<sup>17</sup> That day 60 days after the expected date of publication is August 12, 2019,<sup>18</sup> though since the regulations apply to contributions made after August 27, 2018 it's not clear the August 12 date will have any significant impact.

## **Section: 983 I Regulations Issued Creating Individual Coverage HRA and Excepted Benefit HRAs**

**Citation: TD 9867, 6/13/19**

The IRS, Department of Labor and Department of Health and Human Services have issued final regulations providing for expanding the use of health reimbursement arrangements (HRAs) that will qualify under the rules established by the Affordable Care Act, in particular the revisions to Section 2711 of the Public Health Service Act (PHSA).<sup>19</sup>

### **Individual Coverage HRA**

The regulation establishes a new category of HRAs that is to be called an *individual coverage HRA* that an employer may offer that integrates with individual health care policies held by the employee (and, if applicable, his/her dependents and spouse).<sup>20</sup> An *individual coverage HRA* must require participants and any dependents covered by the employer's HRA to be enrolled in individual health coverage and to substantiate compliance with this rule. The regulations require this step to insure compliance with PHSA sections 2711 and 2713.<sup>21</sup>

An individual coverage HRA can only be offered to a class of employees who are not offered access to a traditional group health plan.<sup>22</sup>

Specifically, it is not enough that the employee merely have the ability to acquire individual health coverage—they must actually do so or be barred from the individual coverage HRA.<sup>23</sup> However, the plans in question can be catastrophic plans (as defined in PPACA Section 1302(e))<sup>24</sup> or “grandmothered” plans (non-grandfathered coverage that CMS has indicated it

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<sup>17</sup> *Ibid.*, p. 1

<sup>18</sup> IR-2019-109, “Final Regulations on Charitable Contributions and State and Local Tax Credits,” June 11, 2019

<sup>19</sup> TD 9867, [https://s3.amazonaws.com/public-inspection.federalregister.gov/2019-12571.pdf?utm\\_source=federalregister.gov&utm\\_medium=email&utm\\_campaign=pi+subscription+mailing+list](https://s3.amazonaws.com/public-inspection.federalregister.gov/2019-12571.pdf?utm_source=federalregister.gov&utm_medium=email&utm_campaign=pi+subscription+mailing+list), accessed on June 13, 2019, Reg. §54.9804-2

<sup>20</sup> *Ibid.*, p. 24, Reg. §54-9804-2(c)(1)

<sup>21</sup> *Ibid.*, p. 25, Reg. §54-9804-2(c)(ii)

<sup>22</sup> Reg. §54-9804-2(c)(2)

<sup>23</sup> *Ibid.*, p. 40

<sup>24</sup> *Ibid.*, pp. 42-43

## 8 Current Federal Tax Developments

will not take enforcement action against for renewals through policy years beginning on or before October 1, 2020 if the plan comes into compliance by January 1, 2021).<sup>25</sup>

As well, employees who hold grandfathered coverage that is otherwise not compliant with PHSA Sections 2711 and 2713 will still qualify to enroll in an individual coverage HRA.<sup>26</sup>

The regulations provide that an employee can be allowed to purchase individual coverage, other than that offered on an Exchange, via a cafeteria plan that provides for such an option.<sup>27</sup>

### Class of Employees

The regulations require generally that if a plan sponsor offers an individual coverage HRA to a class of employees, it must offer the HRA on same terms, including amounts and other terms, to all employees in that class.<sup>28</sup> The rules do allow for an exception to this requirement if the maximum amount available to a participant from the individual coverage increases as the age of the employee increases, so long as the amount made available to the oldest participant is no more than three times the amount made available to the youngest participant.<sup>29</sup> The maximum amount available to an employee under the plan is also allowed to increase as the number of dependents covered under the HSA increases as long as the rule is applied consistently for all employees in the class.<sup>30</sup>

#### **REGULATION EXAMPLE BASED ON SAME TERMS REQUIREMENT**<sup>31</sup>

*Example 5: Application of same terms requirement to premium only HRA--(1) Facts. For 2020, Plan Sponsor E offers its employees an HRA that reimburses only premiums for individual health insurance coverage, up to \$10,000 for the year. Employee A enrolls in individual health insurance coverage with a \$5,000 premium for the year and is reimbursed \$5,000 from the HRA. Employee B enrolls in individual health insurance coverage with an \$8,000 premium for the year and is reimbursed \$8,000 from the HRA.*

*(2) Conclusion. The same terms requirement of this paragraph (c)(3) is satisfied in this paragraph (c)(3)(vii)(E) (Example 5) because Plan Sponsor E offers the HRA on the same terms to all employees, notwithstanding that some employees receive a greater amount of reimbursement than others based on the cost of the individual health insurance coverage selected by the employee.*

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<sup>25</sup> *Ibid*, p. 43

<sup>26</sup> *Ibid*, pp. 44-45

<sup>27</sup> *Ibid*, pp. 57-59

<sup>28</sup> *Ibid*, p. 59, Reg. §54-9804-2(c)(3)

<sup>29</sup> *Ibid*, p. 61, Reg. §54-9802-4(c)(3)(iii)(B)

<sup>30</sup> *Ibid*, p. 62, Reg. §54-9802-4(c)(3)(iii)(A)

<sup>31</sup> Reg. §54-9802-4(c)(vii)

**REGULATION EXAMPLE BASED ON INCREASE IN EMPLOYEE'S AGE<sup>32</sup>**

*Example 4: HRA amounts offered vary based on increases in employees' ages--(1) Facts. For 2020, Plan Sponsor D offers its employees the following amounts in an HRA: \$1,000 each for employees age 25 to 35; \$2,000 each for employees age 36 to 45; \$2,500 each for employees age 46 to 55; and \$4,000 each for employees over age 55.*

*(2) Conclusion. The same terms requirement of this paragraph (c)(3) is not satisfied in this paragraph (c)(3)(vii)(D) (Example 4) because the terms of the HRA provide the oldest participants (those over age 55) with more than three times the amount made available to the youngest participants (those ages 25 to 35), in violation of paragraph (c)(3)(iii)(B)(2) of this section.*

**REGULATION EXAMPLE BASED ON VARYING NUMBER OF DEPENDENTS<sup>33</sup>**

*Example 3: HRA amounts offered vary based on number of dependents--(1) Facts. For 2020, Plan Sponsor C offers its employees the following amounts in an HRA: \$1,500, if the employee is the only individual covered by the HRA; \$3,500, if the employee and one dependent are covered by the HRA; and \$5,000, if the employee and more than one dependent are covered by the HRA.*

*(2) Conclusion. The same terms requirement of this paragraph (c)(3) is satisfied in this paragraph (c)(3)(vii)(C) (Example 3) because paragraph (c)(3)(iii)(A) of this section allows the maximum dollar amount made available in an HRA to increase as the number of the participant's dependents covered by the HRA increases and Plan Sponsor C makes the same amount available to each employee with the same number of dependents covered by the HRA.*

**Former Employees**

There are special rules that apply to covering former employees that relax the same terms requirement. Individual coverage HRAs may be provided to some, but not all, former employees within a class of employees, such as all former employees who meet a minimum term of employment.<sup>34</sup> However, it must offer the HRA on similar terms to all similarly situated former employees within that group.<sup>35</sup>

**EXAMPLE ADAPTED FROM PREAMBLE<sup>36</sup>**

*Nick's Bakery offers an individual coverage HRA that is also available to its former employees at retirement, but only to those former employees who had at least 5 years of services as an employee with*

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<sup>32</sup> Reg. §54-9802-4(c)(vii)

<sup>33</sup> Reg. §54-9802-4(c)(vii)

<sup>34</sup> *Ibid*, p. 65, Reg. §54-9802-4(c)(3)(iv)

<sup>35</sup> *Ibid*, pp. 65-66, Reg. §54-9802-4(c)(3)(iv)

<sup>36</sup> *Ibid*, p. 66

*Nick's. Each covered former employee is entitled to a maximum reimbursement under the HRA of \$5,000.*

*This program meets the special same terms test for former employees.*

**EXAMPLE ADAPTED FROM PREAMBLE<sup>37</sup>**

*Assume Nick's program offered an additional \$5,000 in maximum reimbursement to those employees with more than 10 years of employment with Nick's. The different levels of maximum reimbursement based on years of service would violate the special same terms test for former employees.*

The preamble notes that plans that cover less than two current employees are not subject to the market requirements. Thus, a retiree-only HRA would not have to satisfy the same terms test.<sup>38</sup>

**Entry After Beginning of Plan Year**

A plan will not violate the same terms requirement if it offers employees who qualify for coverage under an individual coverage HRA after the first day of the plan year the full annual benefit or adopts a reasonable proration strategy.<sup>39</sup> A similar rule applies to participants where the number of dependents increases or decreases during the year.<sup>40</sup>

**REGULATION EXAMPLE FOR NEWLY HIRED EMPLOYEES<sup>41</sup>**

*Example 2: Employees hired after the first day of the plan year--(1) Facts. For 2020, Plan Sponsor B offers all employees employed on January 1, 2020, \$7,000 each in an HRA for the plan year. Employees hired after January 1, 2020, are eligible to enroll in the HRA with an effective date of the first day of the month following their date of hire, as long as they have enrolled in individual health insurance coverage effective on or before that date, and the amount offered to these employees is pro-rated based on the number of months remaining in the plan year, including the month which includes their coverage effective date.*

*(2) Conclusion. The same terms requirement of this paragraph (c)(3) is satisfied in this paragraph (c)(3)(vii)(B) (Example 2) for 2020 because Plan Sponsor B offers all employees employed on the first day of the plan year the same amount, \$7,000, in an HRA for that plan year and all employees hired after January 1, 2020, a pro-rata amount based on the portion of the plan year during which they are enrolled in the HRA.*

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<sup>37</sup> *Ibid*

<sup>38</sup> *Ibid*, p. 67

<sup>39</sup> *Ibid*, p. 67, Reg. §54-9802-4(c)(3)(v)

<sup>40</sup> *Ibid*, pp. 67-68, Reg. §54-9802-4(c)(3)(v)

<sup>41</sup> Reg §54-9802-4(c)(3)(vii)

**REGULATION EXAMPLE FOR NO HRA OFFERED<sup>42</sup>**

*Example 14: No employees offered an HRA--(A) Facts. The facts are the same facts as in paragraph (f)(1)(xiii) of this section (Example 13), except that Plan Sponsor K offers its full-time employees a traditional group health plan and does not offer any group health plan (either a traditional group health plan or an HRA) to its part-time employees.*

*(B) Conclusion. The regulations set forth under this section do not apply to Plan Sponsor K because Plan Sponsor K does not offer an individual coverage HRA to any employee.*

**Allowed Classes of Employees**

The regulations allow the following classes of employees to be used for purposes of offering HRAs to a class of employees:

- Full-time employees (using either the definition that applies for purposes of Code section 105(h) or 4980H, as determined by the plan sponsor);
- Part-time employees (using either the definition that applies for purposes of Code section 105(h) or 4980H, as determined by the plan sponsor);
- Seasonal employees (using either the definition that applies for purposes of Code section 105(h) or 4980H, as determined by the plan sponsor);
- Employees who are included in a unit of employees covered by a collective bargaining agreement (CBA) in which the plan sponsor participates (the CBA class of employees);
- Employees who have not satisfied a waiting period for coverage (if the waiting period complies with the waiting period rules in PHS Act section 2708 and its implementing rules) (the waiting period class);
- Employees who are non-resident aliens with no U.S.-based income (generally, foreign employees who work abroad) (the non-resident alien class);
- Employees whose primary site of employment is in the same rating area, as defined in 45 CFR 147.102(b) (the rating area class);<sup>43</sup>
- Salaried and non-salaried employee;<sup>44</sup> and
- Individuals who, under all the facts and circumstances, are the employees of an entity that hired the employees for temporary placement at an unrelated entity (that is, another entity that is not the common law employer of the employees and that is not treated as a single employer under Code section 414(b), (c), (m), or (o) with the entity that hired the employees for temporary placement).<sup>45</sup>

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<sup>42</sup> Reg §54-9802-4(c)(3)(vii)

<sup>43</sup> *Ibid*, pp. 70-76, Reg. §54.9802-4(d)(1)

<sup>44</sup> *Ibid*, p. 78, Reg. §54.9802-4(d)(1)

<sup>45</sup> *Ibid*, p. 78-79, Reg. §54.9802-4(d)(1)



**REGULATION EXAMPLE OF CLASSES<sup>46</sup>**

*Example 1: Collectively bargained employees offered traditional group health plan; non-collectively bargained employees offered HRA--(A) Facts. For 2020, Plan Sponsor A offers its employees covered by a collective bargaining agreement a traditional group health plan (as required by the collective bargaining agreement) and all other employees (non-collectively bargained employees) each an HRA on the same terms.*

*(B) Conclusion. The same terms requirement of paragraph (c)(3) of this section is satisfied in this paragraph (f)(1)(i) (Example 1) because collectively bargained and noncollectively bargained employees may be treated as different classes of employees, one of which may be offered a traditional group health plan and the other of which may be offered an individual coverage HRA, and Plan Sponsor A offers the HRA on the same terms to all participants who are non-collectively bargained employees. The minimum class size requirement does not apply to this paragraph (f)(1)(i) (Example 1) even though Plan Sponsor A offers one class a traditional group health plan and one class the HRA because collectively bargained and non-collectively bargained employees are not applicable classes that are subject to the minimum class size requirement.*

**REGULATION EXAMPLE OF COLLECTIVELY BARGAINED CLASSES<sup>47</sup>**

*Example 2: Collectively bargained employees in one unit offered traditional group health plan and in another unit offered HRA--(A) Facts. For 2020, Plan Sponsor B offers its employees covered by a collective bargaining agreement with Local 100 a traditional group health plan (as required by the collective bargaining agreement), and its employees covered by a collective bargaining agreement with Local 200 each an HRA on the same terms (as required by the collective bargaining agreement).*

*(B) Conclusion. The same terms requirement of paragraph (c)(3) of this section is satisfied in this paragraph (f)(1)(ii) (Example 2) because the employees covered by the collective bargaining agreements with the two separate bargaining units (Local 100 and Local 200) may be treated as two different classes of employees and Plan Sponsor B offers an HRA on the same terms to the participants covered by the agreement with Local 200. The minimum class size requirement does not apply to this paragraph (f)(1)(ii) (Example 2) even though Plan Sponsor B offers the Local 100 employees a traditional group health plan and the Local 200 employees an HRA because collectively bargained employees are not applicable classes that are subject to the minimum class size requirement.*

**REGULATION EXAMPLE OF WAITING PERIOD AND CLASS<sup>48</sup>**

*Example 3: Employees in a waiting period offered no coverage; other employees offered an HRA--(A) Facts. For 2020, Plan Sponsor C offers its employees who have completed a waiting period that complies with the requirements for waiting periods in § 54.9815-2708 of this chapter each an HRA on the same terms and does not offer coverage to its employees who have not completed the waiting period.*

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<sup>46</sup> Reg. §54.9802-4(f)(1)

<sup>47</sup> Reg. §54.9802-4(f)(1)

<sup>48</sup> Reg. §54.9802-4(f)(1)



*(B) Conclusion. The same terms requirement of paragraph (c)(3) of this section is satisfied in this paragraph (f)(1)(iii) (Example 3) because employees who have completed a waiting period and employees who have not completed a waiting period may be treated as different classes and Plan Sponsor C offers the HRA on the same terms to all participants who have completed the waiting period. The minimum class size requirement does not apply to this paragraph (f)(1)(iii) (Example 3) because Plan Sponsor C does not offer at least one class of employees a traditional group health plan and because the class of employees who have not completed a waiting period and the class of employees who have completed a waiting period are not applicable classes that are subject to the minimum class size requirement.*

**REGULATION EXAMPLE OF WAITING PERIOD AND CLASS<sup>49</sup>**

*Example 4: Employees in a waiting period offered an HRA; other employees offered a traditional group health plan--(A) Facts. For 2020, Plan Sponsor D offers its employees who have completed a waiting period that complies with the requirements for waiting periods in § 54.9815-2708 of this chapter a traditional group health plan and offers its employees who have not completed the waiting period each an HRA on the same terms.*

*(B) Conclusion. The same terms requirement of paragraph (c)(3) of this section is satisfied in this paragraph (f)(1)(iv) (Example 4) because employees who have completed a waiting period and employees who have not completed a waiting period may be treated as different classes and Plan Sponsor D offers an HRA on the same terms to all participants who have not completed the waiting period. The minimum class size requirement does not apply to this paragraph (f)(1)(iv) (Example 4) even though Plan Sponsor D offers employees who have completed a waiting period a traditional group health plan and employees who have not completed a waiting period an HRA because the class of employees who have not completed a waiting period is not an applicable class that is subject to the minimum class size requirement (nor is the class made up of employees who have completed the waiting period).*

**REGULATION EXAMPLE OF STAFFING FIRM EMPLOYEE CLASS<sup>50</sup>**

*Example 5: Staffing firm employees temporarily placed with customers offered an HRA; other employees offered a traditional group health plan--(A) Facts. Plan Sponsor E is a staffing firm that places certain of its employees on temporary assignments with customers that are not the common law employers of Plan Sponsor E's employees or treated as a single employer with Plan Sponsor E under section 414(b), (c), (m), or (o) (unrelated entities); other employees work in Plan Sponsor E's office managing the staffing business (non-temporary employees). For 2020, Plan Sponsor E offers its employees who are on temporary assignments with customers each an HRA on the same terms. All other employees are offered a traditional group health plan.*

*(B) Conclusion. The same terms requirement of paragraph (c)(3) of this section is satisfied in this paragraph (f)(1)(v) (Example 5) because the employees who are hired for temporary placement at an unrelated entity and non-temporary employees of Plan Sponsor E may be treated as different classes of*

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<sup>49</sup> Reg. §54.9802-4(f)(1)

<sup>50</sup> Reg. §54.9802-4(f)(1)

employees and Plan Sponsor E offers an HRA on the same terms to all participants temporarily placed with customers. The minimum class size requirement does not apply to this paragraph (f)(1)(v) (Example 5) even though Plan Sponsor E offers one class a traditional group health plan and one class the HRA because the class of employees hired for temporary placement is not an applicable class that is subject to the minimum class size requirement (nor is the class made up of non-temporary employees).

**REGULATION EXAMPLE OF DIFFERENT RATING AREA CLASS<sup>51</sup>**

*Example 7: Employees in State 1 offered traditional group health plan; employees in State 2 offered HRA--(A) Facts. Plan Sponsor F employs 45 employees whose work site is in State 1 and 7 employees whose primary site of employment is in State 2. For 2020, Plan Sponsor F offers its 45 employees in State 1 a traditional group health plan, and each of its 7 employees in State 2 an HRA on the same terms.*

*(B) Conclusion. The same terms requirement of paragraph (c)(3) of this section is satisfied in this paragraph (f)(1)(vii) (Example 7) because Plan Sponsor F offers the HRA on the same terms to all employees with a work site in State 2 and that class is a permissible class under paragraph (d) of this section. This is because employees whose work sites are in different rating areas may be considered different classes and a plan sponsor may create a class of employees by combining classes of employees, including by combining employees whose work site is in one rating area with employees whose work site is in a different rating area, or by combining all employees whose work site is in a state. The minimum class size requirement does not apply to this paragraph (f)(1)(vii) (Example 7) because the minimum class size requirement does not apply if the geographic area defining a class of employees is a state or a combination of two or more entire states.*

**REGULATION EXAMPLE OF SEASONAL EMPLOYEES<sup>52</sup>**

*Example 8: Full-time seasonal employees offered HRA; all other full-time employees offered traditional group health plan; part-time employees offered no coverage--(A) Facts. Plan Sponsor G employs 6 full-time seasonal employees, 75 full-time employees who are not seasonal employees, and 5 part-time employees. For 2020, Plan Sponsor G offers each of its 6 full-time seasonal employees an HRA on the same terms, its 75 full-time employees who are not seasonal employees a traditional group health plan, and offers no coverage to its 5 part-time employees.*

*(B) Conclusion. The same terms requirement of paragraph (c)(3) of this section is satisfied in this paragraph (f)(1)(viii) (Example 8) because full-time seasonal employees and fulltime employees who are not seasonal employees may be considered different classes and Plan Sponsor G offers the HRA on the same terms to all full-time seasonal employees. The minimum class size requirement does not apply to the class offered the HRA in this paragraph (f)(1)(viii) (Example 8) because part-time employees are not offered coverage and full-time employees are not an applicable class subject to the minimum class size requirement if part-time employees are not offered coverage.*

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<sup>51</sup> Reg. §54.9802-4(f)(1)

<sup>52</sup> Reg. §54.9802-4(f)(1)

## Minimum Class Size Rule

Subject to minimum class size rules in certain situations, employers are also allowed to combine these classes to create additional sub-classes (such as full-time employees covered by a CBA) for these purposes.<sup>53</sup>

The preamble describes this minimum class size rule added in the final regulations:

*In order to balance these various considerations, the final rules include a minimum class size requirement that varies based on employer size and that applies only to certain classes of employees in certain circumstances in which the potential for adverse selection is greatest. If a class of employees is subject to the minimum class size requirement, the class must include a minimum number of employees for the individual coverage HRA to be offered to that class. The final rules explain the circumstances in which the minimum class size requirement applies, how to determine the applicable class size minimum, and how an individual coverage HRA determines if a particular class of employees satisfies the applicable class size minimum. The final rules also provide a number of examples to illustrate each aspect of the minimum class size requirement.*

*As to the circumstances in which the minimum class size requirement applies, it applies only if the plan sponsor offers a traditional group health plan to at least one other class of employees and offers an individual coverage HRA to at least one class of employees. To the extent the minimum class size requirement applies, it applies only to certain classes that are offered an individual coverage HRA. The minimum class size requirement does not apply to a class of employees offered a traditional group health plan or to a class of employees that is not offered any group health plan.<sup>54</sup>*

The minimum size requirements generally apply to the following classes of employees (which are referred to in the regulations as *applicable classes*):

- Salaried employees,
- Non-salaried employees,
- Full-time employees,
- Part-time employees, and
- Employees whose primary site of employment is in the same rating area (although the minimum class size requirement does not apply if the geographic area defining the class is a state or a combination of two or more entire states)<sup>55</sup>

For the full-time and part-time employee classes, the rules only apply if the employees in one of those classes is offered a traditional group health plan while those in the other group are offered an individual coverage HRA.<sup>56</sup> The minimum class size rules applies to a class of employees

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<sup>53</sup> *Ibid*, pp. 70, 76

<sup>54</sup> *Ibid*, p. 83

<sup>55</sup> *Ibid*, p. 84, Reg. §54.9802-4(d)(3)(ii)

<sup>56</sup> *Ibid*, Reg. §54.9802-4(d)(3)(ii)

## 16 Current Federal Tax Developments

created by combining any of the applicable classes with any other class of employees *except* for a combination with the waiting period class.<sup>57</sup>

The *applicable class size minimum* is calculated based on the number of employees of an employer as follows:

- 10, for an employer with fewer than 100 employees;
- A number, *rounded down to a whole number*, equal to 10 percent of the total number of employees, for an employer with 100 to 200 employees; and
- 20, for an employer that has more than 200 employees.<sup>58</sup>

The overall number of employees of an employer is to be calculated based on the employer's reasonable expectation of the number of employees it will employ on the first day of the plan year of the individual coverage HRA program and the number in the class are based on those offered the individual coverage HRA program on the first day of the plan year.<sup>59</sup> Note that an employer with less than 10 employees will not be able to combine applicable classes with any class except the waiting period class, since the resulting class would, by definition, have fewer than 10 employees.

### **EXAMPLE**

*Martin Manufacturing creates a class of employees who are hourly employees not covered by a collective bargaining agreement who are offered a plan with an individual coverage HRA. Martin expects to employ 128 employees on the first day of the plan year.*

*The hourly employees not covered by a collective bargaining agreement group must have at least 12 members, which is determined by those offered this program on the first day of the plan year.*

### **EXAMPLE**

*The hourly employees not covered by a collective bargaining agreement group had 14 members on the first day of the plan year. However, only 7 of those employees obtained individual coverage and thus only those 7 were enrolled in the program.*

*Even the number actually participating in the program is less than the minimum class size, that is not an issue. The test is solely based on those offered the program, not based on those who actually choose to enroll.*

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A former employee is treated as a member of the same class of employee he/she was a member of immediately before termination if they participate in a plan that includes more than one

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<sup>57</sup> *Ibid*, p. 85, Reg. §54.9802-4(d)(3)(ii)(D)

<sup>58</sup> *Ibid*, Reg. §54.9802-4(d)(3)(iii)(A)

<sup>59</sup> *Ibid*, Reg. §54.9802-4(d)(3)(iv)

current employee. Plans that only cover former employees are not affected by this rule, since such programs are exempt from the market requirements.<sup>60</sup>

Even if an employer is a member of a controlled group, the class rules are applied only at the common law employer level.<sup>61</sup>

If an employee ceases to be a member of the group offered the individual coverage due to an event triggering COBRA rules, those rules would continue to apply. However, if the event is not a COBRA triggering event (such as, say, going from part-time to full-time employment), the individual coverage HRA must still allow the employee to submit claims for covered expenses incurred before the date of the change in status for a reasonable time frame specified in the plan.<sup>62</sup>

**REGULATION EXAMPLE OF STAFFING FIRM EMPLOYEE CLASS AND MINIMUM SIZE REQUIREMENT**<sup>63</sup>

*Example 6: Staffing firm employees temporarily placed with customers in rating area 1 offered an HRA; other employees offered a traditional group health plan--(A) Facts. The facts are the same as in paragraph (f)(1)(v) of this section (Example 5), except that Plan Sponsor E has work sites in rating area 1 and rating area 2, and it offers its 10 employees on temporary assignments with a work site in rating area 1 an HRA on the same terms. Plan Sponsor E has 200 other employees in rating areas 1 and 2, including its non-temporary employees in rating areas 1 and 2 and its employees on temporary assignments with a work site in rating area 2, all of whom are offered a traditional group health plan.*

*(B) Conclusion. The same terms requirement of paragraph (c)(3) of this section is not satisfied in this paragraph (f)(1)(vi) (Example 6) because, even though the employees who are temporarily placed with customers generally may be treated as employees of a different class, because Plan Sponsor E is also using a rating area to identify the class offered the HRA (which is an applicable class for the minimum class size requirement) and is offering one class the HRA and another class the traditional group health plan, the minimum class size requirement applies to the class offered the HRA, and the class offered the HRA fails to satisfy the minimum class size requirement. Because Plan Sponsor E employs 210 employees, the applicable class size minimum is 20, and the HRA is offered to only 10 employees.*

**REGULATION EXAMPLE OF FULL TIME AND RATING EMPLOYEES EXCEPTION TO MINIMUM SIZE REQUIREMENT**<sup>64</sup>

*Example 9: Full-time employees in rating area 1 offered traditional group health plan; full-time employees in rating area 2 offered HRA; part-time employees offered no coverage--(A) Facts. Plan Sponsor H employs 17 full-time employees and 10 part-time employees whose work site is in rating area*

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<sup>60</sup> *Ibid*, pp. 88-89

<sup>61</sup> *Ibid*, p. 90

<sup>62</sup> *Ibid*, p. 90

<sup>63</sup> Reg. §54.9802-4(f)(1)

<sup>64</sup> Reg. §54.9802-4(f)(1)

1 and 552 full-time employees whose work site is in rating area 2. For 2020, Plan Sponsor H offers its 17 full-time employees in rating area 1 a traditional group health plan and each of its 552 full-time employees in rating area 2 an HRA on the same terms. Plan Sponsor H offers no coverage to its 10 part-time employees in rating area 1. Plan Sponsor H reasonably expects to employ 569 employees on the first day of the HRA plan year.

(B) Conclusion. The same terms requirement of paragraph (c)(3) of this section is satisfied in this paragraph (f)(1)(ix) (Example 9) because employees whose work sites are in different rating areas may be considered different classes and Plan Sponsor H offers the HRA on the same terms to all full-time employees in rating area 2. The minimum class size requirement applies to the class offered the HRA in this paragraph (f)(1)(ix) (Example 9) because the minimum class size requirement applies to a class based on a geographic area unless the geographic area is a state or a combination of two or more entire states. However, the minimum class size requirement applies only to the class offered the HRA, and Plan Sponsor H offers the HRA to the 552 full-time employees in rating area 2 on the first day of the plan year, satisfying the minimum class size requirement (because the applicable class size minimum for Plan Sponsor H is 20).

**REGULATION EXAMPLE OF RATING EMPLOYEES MINIMUM SIZE REQUIREMENT<sup>65</sup>**

Example 10: Employees in rating area 1 offered HRA; employees in rating area 2 offered traditional group health plan--(A) Facts. The facts are the same as in paragraph (f)(1)(ix) of this section (Example 9) except that Plan Sponsor H offers its 17 full-time employees in rating area 1 the HRA and offers its 552 full-time employees in rating area 2 the traditional group health plan.

(B) Conclusion. The same terms requirement of paragraph (c)(3) of this section is not satisfied in this paragraph (f)(1)(x) (Example 10) because, even though employees whose work sites are in different rating areas generally may be considered different classes and Plan Sponsor H offers the HRA on the same terms to all participants in rating area 1, the HRA fails to satisfy the minimum class size requirement. Specifically, the minimum class size requirement applies to this paragraph (f)(1)(x) (Example 10) because the minimum class size requirement applies to a class based on a geographic area unless the geographic area is a state or a combination of two or more entire states. Further, the applicable class size minimum for Plan Sponsor H is 20 employees, and the HRA is only offered to the 17 full-time employees in rating area 1 on the first day of the HRA plan year.

**REGULATION EXAMPLE OF RATING EMPLOYEES MINIMUM SIZE REQUIREMENT<sup>66</sup>**

Example 11: Employees in State 1 and rating area 1 of State 2 offered HRA; employees in all other rating areas of State 2 offered traditional group health plan--(A) Facts. For 2020, Plan Sponsor I offers an HRA on the same terms to a total of 200 employees it employs with work sites in State 1 and in rating area 1 of State 2. Plan Sponsor I offers a traditional group health plan to its 150 employees

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<sup>65</sup> Reg. §54.9802-4(f)(1)

<sup>66</sup> Reg. §54.9802-4(f)(1)



with work sites in other rating areas in State 2. Plan Sponsor I reasonably expects to employ 350 employees on the first day of the HRA plan year.

(B) *Conclusion.* The same terms requirement of paragraph (c)(3) of this section is satisfied in this paragraph (f)(1)(xi) (Example 11). Plan Sponsor I may treat all of the employees with a work site in State 1 and rating area 1 of State 2 as a class of employees because employees whose work sites are in different rating areas may be considered different classes and a plan sponsor may create a class of employees by combining classes of employees, including by combining employees whose work site is in one rating area with a class of employees whose work site is in a different rating area. The minimum class size requirement applies to the class of employees offered the HRA (made up of employees in State 1 and in rating area 1 of State 2) because the minimum class size requirement applies to a class based on a geographic area unless the geographic area is a state or a combination of two or more entire states. In this case, the class is made up of a state plus a rating area which is not the entire state. However, this class satisfies the minimum class size requirement because the applicable class size minimum for Plan Sponsor I is 20, and Plan Sponsor I offered the HRA to 200 employees on the first day of the plan year.

**REGULATION EXAMPLE OF SALARIED/HOURLY EMPLOYEES  
MINIMUM SIZE REQUIREMENT<sup>67</sup>**

*Example 12: Salaried employees offered a traditional group health plan; hourly employees offered an HRA--(A) Facts.* Plan Sponsor J has 163 salaried employees and 14 hourly employees. For 2020, Plan Sponsor J offers its 163 salaried employees a traditional group health plan and each of its 14 hourly employees an HRA on the same terms. Plan Sponsor J reasonably expects to employ 177 employees on the first day of the HRA plan year.

(B) *Conclusion.* The same terms requirement of paragraph (c)(3) of this section is not satisfied in this paragraph (f)(1)(xii) (Example 12) because, even though salaried and hourly employees generally may be considered different classes and Plan Sponsor J offers the HRA on the same terms to all hourly employees, the HRA fails to satisfy the minimum class size requirement. Specifically, the minimum class size requirement applies in this paragraph (f)(1)(xii) (Example 12) because employees who are paid on a salaried basis and employees who are not paid on a salaried basis are applicable classes subject to the minimum class size requirement. Because Plan Sponsor J reasonably expects to employ between 100 and 200 employees on the first day of the plan year, the applicable class size minimum is 10 percent, rounded down to a whole number. Ten percent of 177 total employees, rounded down to a whole number is 17, and the HRA is offered to only 14 hourly employees.

**REGULATION EXAMPLE OF EXCEPTION TO MINIMUM SIZE  
REQUIREMENT WHEN NO TRADITIONAL GROUP PLAN OFFERED<sup>68</sup>**

*Example 13: Part-time employees and full-time employees offered different HRAs; no traditional group health plan offered--(A) Facts.* Plan Sponsor K has 50 full-time employees and 7 part-time employees.

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<sup>67</sup> Reg. §54.9802-4(f)(1)

<sup>68</sup> Reg. §54.9802-4(f)(1)

*For 2020, Plan Sponsor K offers its 50 full-time employees \$2,000 each in an HRA otherwise provided on the same terms and each of its 7 part-time employees \$500 in an HRA otherwise provided on the same terms. Plan Sponsor K reasonably expects to employ 57 employees on the first day of the HRA plan year.*

*(B) Conclusion. The same terms requirement of paragraph (c)(3) of this section is satisfied in this paragraph (f)(1)(xiii) (Example 13) because full-time employees and part-time employees may be treated as different classes and Plan Sponsor K offers an HRA on the same terms to all the participants in each class. The minimum class size requirement does not apply to either the full-time class or the part-time class because (although in certain circumstances the minimum class size requirement applies to a class of full-time employees and a class of part-time employees) Plan Sponsor K does not offer any class of employees a traditional group health plan, and the minimum class size requirement applies only when, among other things, at least one class of employees is offered a traditional group health plan while another class is offered an HRA.*

**REGULATION EXAMPLE OF TRADITIONAL GROUP PLAN AND HRA AND MINIMUM SIZE REQUIREMENTS<sup>69</sup>**

*Example 15: Full-time employees offered traditional group health plan; part-time employees offered HRA--(A) Facts. The facts are the same as in paragraph (f)(1)(xiii) of this section (Example 13), except that Plan Sponsor K offers its full-time employees a traditional group health plan and offers each of its part-time employees \$500 in an HRA and otherwise on the same terms.*

*(B) Conclusion. The same terms requirement of paragraph (c)(3) of this section is not satisfied in this paragraph (f)(1)(xv) (Example 15) because, even though the full-time employees and the part-time employees generally may be treated as different classes, in this paragraph (f)(1)(xv) (Example 15), the minimum class size requirement applies to the part-time employees, and it is not satisfied. Specifically, the minimum class size requirement applies to the part-time employees because that requirement applies to an applicable class offered an HRA when one class is offered a traditional group health plan while another class is offered an HRA, and to the part-time and full-time employee classes when one of those classes is offered a traditional group health plan while the other is offered an HRA. Because Plan Sponsor K reasonably expects to employ fewer than 100 employees on the first day of the HRA plan year, the applicable class size minimum for Plan Sponsor K is 10 employees, but Plan Sponsor K offered the HRA only to its 7 part-time employees.*

**REGULATION EXAMPLE OF SATISFYING MINIMUM CLASS SIZE REQUIREMENT BASED ON EMPLOYEES OFFERED HSA<sup>70</sup>**

*Example 16: Satisfying minimum class size requirement based on employees offered HRA--(A) Facts. Plan Sponsor L employs 78 full-time employees and 12 part-time employees. For 2020, Plan Sponsor L offers its 78 full-time employees a traditional group health plan and each of its 12 part-times*

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<sup>69</sup> Reg. §54.9802-4(f)(1)

<sup>70</sup> Reg. §54.9802-4(f)(1)



employees an HRA on the same terms. Only 6 part-time employees enroll in the HRA. Plan Sponsor L reasonably expects to employ fewer than 100 employees on the first day of the HRA plan year.

(B) *Conclusion.* The same terms requirement of paragraph (c)(3) of this section is satisfied in this paragraph (f)(1)(xvi) (Example 16) because full-time employees and part-time employees may be treated as different classes, Plan Sponsor L offers an HRA on the same terms to all the participants in the part-time class, and the minimum class size requirement is satisfied. Specifically, whether a class of employees satisfies the applicable class size minimum is determined as of the first day of the plan year based on the number of employees in a class that is offered an HRA, not on the number of employees who enroll in the HRA. The applicable class size minimum for Plan Sponsor L is 10 employees, and Plan Sponsor L offered the HRA to its 12 part-time employees.

### **REGULATION EXAMPLE OF STUDENT EMPLOYEES<sup>71</sup>**

*Example 17: Student employees offered student premium reduction arrangements and same terms requirement--(A) Facts.* Plan Sponsor M is an institution of higher education that offers each of its part-time employees an HRA on the same terms, except that it offers its parttime employees who are student employees a student premium reduction arrangement, and the student premium reduction arrangement provides different amounts to different part-time student employees.

(B) *Conclusion.* The same terms requirement of paragraph (c)(3) of this section is satisfied in this paragraph (f)(1)(xvii) (Example 17) because Plan Sponsor M offers the HRA on the same terms to its part-time employees who are not students and because the part-time student employees offered a student premium reduction arrangement (and their varying HRAs) are not taken into account as part-time employees for purposes of determining whether a class of employees is offered an HRA on the same terms.

### **REGULATION EXAMPLE OF STUDENT EMPLOYEES AND MINIMUM CLASS SIZE REQUIREMENT<sup>72</sup>**

*Example 18: Student employees offered student premium reduction arrangements and minimum class size requirement--(A) Facts.* Plan Sponsor N is an institution of higher education with 25 hourly employees. Plan Sponsor N offers 15 of its hourly employees, who are student employees, a student premium reduction arrangement and it wants to offer its other 10 hourly employees an HRA for 2022. Plan Sponsor N offers its salaried employees a traditional group health plan. Plan Sponsor N reasonably expects to have 250 employees on the first day of the 2022 HRA plan year, 15 of which will have offers of student premium reduction arrangements.

(B) *Conclusion.* The same terms requirement of paragraph (c)(3) of this section is not satisfied in this paragraph (f)(1)(xviii) (Example 18). The minimum class size requirement will apply to the class of hourly employees to which Plan Sponsor N wants to offer the HRA because Plan Sponsor N offers a class of employees a traditional group health plan and another class the HRA, and the minimum class size requirement generally applies to a class of hourly employees offered an HRA. Plan Sponsor N's

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<sup>71</sup> Reg. §54.9802-4(f)(1)

<sup>72</sup> Reg. §54.9802-4(f)(1)

*applicable class size minimum is 20 because Plan Sponsor N reasonably expects to employ 235 employees on the first day of the plan year (250 employees minus 15 employees receiving a student premium reduction arrangement). Plan Sponsor N may not offer the HRA to its hourly employees because the 10 employees offered the HRA as of the first day of the plan year does not satisfy the applicable class size minimum.*

### New Hire Dates

The regulations contain a special rule that allows employers the option for an employer who currently offers a traditional group health plan to a class of employees may *prospectively* offer employees hired on or after a certain date in the future (the *new hire date*) an individual coverage HRA (the *new hire subclass*), while continuing to offer the traditional health plan to those who were hired before the new hire date. The new hire date can be set prospectively for a class of employees as any date after January 1, 2020 and can set different new hire dates for different classes of employees.<sup>73</sup> Note that the employer *cannot* offer a choice between an individual coverage HRA or a traditional plan to any employee, regardless of this special rule.<sup>74</sup>

The minimum class size requirement does not apply to a new hire subclass, as that would effectively make it impossible to create the class unless at least 10 employees came into the new hire subclass at the same time—not a very likely event, even for relatively large employers.<sup>75</sup>

#### ***REGULATION EXAMPLE OF NEW HIRES***<sup>76</sup>

*Example 1: Application of special rule for new hires to all employees--(A) Facts. For 2021, Plan Sponsor A offers all employees a traditional group health plan. For 2022, Plan Sponsor A offers all employees hired on or after January 1, 2022, an HRA on the same terms and continues to offer the traditional group health plan to employees hired before that date. On the first day of the 2022 plan year, Plan Sponsor A has 2 new hires who are offered the HRA.*

*(B) Conclusion. The same terms requirement of paragraph (c)(3) of this section is satisfied in this paragraph (f)(2)(i) (Example 1) because, under the special rule for new hires in paragraph (d)(5) of this section, the employees newly hired on and after January 1, 2022, may be treated as a new hire subclass, Plan Sponsor A offers the HRA on the same terms to all participants in the new hire subclass, and the minimum class size requirement does not apply to the new hire subclass.*

#### ***REGULATION EXAMPLE OF NEW HIRES***<sup>77</sup>

*Example 2: Application of special rule for new hires to full-time employees--(A) Facts. For 2021, Plan Sponsor B offers a traditional group health plan to its full-time employees and does not offer any coverage to its part-time employees. For 2022, Plan Sponsor B offers fulltime employees hired on or*

<sup>73</sup> *Ibid*, p. 96, Reg. §54.9802-4(d)(5)(ii)

<sup>74</sup> *Ibid*, pp. 96-97, Reg. §54.9802-4(d)(5)(i)

<sup>75</sup> *Ibid*, pp. 97, Reg. §54.9802-4(d)(5)(iv)

<sup>76</sup> Reg. §54.9802-4(f)(2)

<sup>77</sup> Reg. §54.9802-4(f)(2)

after January 1, 2022, an HRA on the same terms, continues to offer its full-time employees hired before that date a traditional group health plan, and continues to offer no coverage to its part-time employees. On the first day of the 2022 plan year, Plan Sponsor B has 2 new hire, full-time employees who are offered the HRA.

(B) *Conclusion.* The same terms requirement of paragraph (c)(3) of this section is satisfied in this paragraph (f)(2)(ii) (Example 2) because, under the special rule for new hires in paragraph (d)(5) of this section, the full-time employees newly hired on and after January 1, 2022, may be treated as a new hire subclass and Plan Sponsor B offers the HRA on the same terms to all participants in the new hire subclass. The minimum class size requirement does not apply to the new hire subclass.

**REGULATION EXAMPLE OF NEW HIRES RULE IMPERMISSIBLY APPLIED RETROACTIVELY<sup>78</sup>**

*Example 3: Special rule for new hires impermissibly applied retroactively--(A) Facts.* For 2025, Plan Sponsor C offers a traditional group health plan to its full-time employees. For 2026, Plan Sponsor C wants to offer an HRA to its full-time employees hired on and after January 1, 2023, while continuing to offer a traditional group health plan to its full-time employees hired before January 1, 2023.

(B) *Conclusion.* The special rule for new hires under paragraph (d)(5) of this section does not apply in this paragraph (f)(2)(iii) (Example 3) because the rule must be applied prospectively. That is, Plan Sponsor C may not, in 2026, choose to apply the special rule for new hires retroactive to 2023. If Plan Sponsor C were to offer an HRA in this way, it would fail to satisfy the conditions under paragraphs (c)(2) and (3) of this section because the new hire subclass would not be treated as a subclass for purposes of applying those rules and, therefore, all full-time employees would be treated as one class to which either a traditional group health plan or an HRA could be offered, but not both.

**REGULATION EXAMPLE OF NEW HIRES RULE APPLIED TO SAME CLASS OF EMPLOYEES<sup>79</sup>**

*Example 4: Permissible second application of the special rule for new hires to the same class of employees--(A) Facts.* For 2021, Plan Sponsor D offers all of its full-time employees a traditional group health plan. For 2022, Plan Sponsor D applies the special rule for new hires and offers an HRA on the same terms to all employees hired on and after January 1, 2022, and continues to offer a traditional group health plan to full-time employees hired before that date. For 2025, Plan Sponsor D discontinues use of the special rule for new hires, and again offers all full-time employees a traditional group health plan. In 2030, Plan Sponsor D decides to apply the special rule for new hires to the full-time employee class again, offering an HRA to all full-time employees hired on and after January 1, 2030, on the same terms, while continuing to offer employees hired before that date a traditional group health plan.

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<sup>78</sup> Reg. §54.9802-4(f)(2)

<sup>79</sup> Reg. §54.9802-4(f)(2)

*(B) Conclusion. Plan Sponsor D has permissibly applied the special rule for new hires and is in compliance with the requirements of paragraphs (c)(2) and (3) of this section.*

**REGULATION EXAMPLE OF IMPERMISSIBLE SECOND APPLICATION OF NEW HIRE RULE TO SAME CLASS OF EMPLOYEES<sup>80</sup>**

*Example 5: Impermissible second application of the special rule for new hires to the same class of employees--(A) Facts. The facts are the same as in paragraph (f)(2)(iv) of this section (Example 4), except that for 2025, Plan Sponsor D discontinues use of the special rule for new hires by offering all full-time employees an HRA on the same terms. Further, for 2030, Plan Sponsor D wants to continue to offer an HRA on the same terms to all full-time employees hired before January 1, 2030, and to offer all full-time employees hired on or after January 1, 2030, an HRA in a different amount.*

*(B) Conclusion. Plan Sponsor D may not apply the special rule for new hires for 2030 to the class of full-time employees being offered an HRA because the special rule for new hires may only be applied to a class that is being offered a traditional group health plan.*

**REGULATION EXAMPLE OF NEW FULL-TIME EMPLOYEES OFFERED DIFFERENT HRAS IN DIFFERENT RATING AREAS<sup>81</sup>**

*Example 6: New full-time employees offered different HRAs in different rating areas--(A) Facts. Plan Sponsor E has work sites in rating area 1, rating area 2, and rating area 3. For 2021, Plan Sponsor E offers its full-time employees a traditional group health plan. For 2022, Plan Sponsor E offers its full-time employees hired on or after January 1, 2022, in rating area 1 an HRA of \$3,000, its full-time employees hired on or after January 1, 2022, in rating area 2 an HRA of \$5,000, and its full-time employees hired on or after January 1, 2022, in rating area 3 an HRA of \$7,000. Within each class offered an HRA, Plan Sponsor E offers the HRA on the same terms. Plan Sponsor E offers its full-time employees hired prior to January 1, 2022, in each of those classes a traditional group health plan. On the first day of the 2022 plan year, there is one new hire, full-time employee in rating area 1, three new hire, full-time employees in rating area 2, and 10 new hire-full-time employees in rating area 3.*

*(B) Conclusion. The same terms requirement of paragraph (c)(3) of this section is satisfied in this paragraph (f)(2)(vi) (Example 6) because, under the special rule for new hires in paragraph (d)(5) of this section, the full-time employees in each of the three rating areas newly hired on and after January 1, 2022, may be treated as three new hire subclasses and Plan Sponsor E offers the HRA on the same terms to all participants in the new hire subclasses. Further, the minimum class size requirement does not apply to the new hire subclasses.*

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<sup>80</sup> Reg. §54.9802-4(f)(2)

<sup>81</sup> Reg. §54.9802-4(f)(2)

**REGULATION EXAMPLE OF NEW FULL-TIME EMPLOYEES  
SUBDIVIDED BASED ON RATING AREA<sup>82</sup>**

*Example 7: New full-time employee class subdivided based on rating area--(A) Facts. Plan Sponsor F offers its full-time employees hired on or after January 1, 2022, an HRA on the same terms and it continues to offer its full-time employees hired before that date a traditional group health plan. Plan Sponsor F offers no coverage to its part-time employees. For the 2025 plan year, Plan Sponsor F wants to subdivide the full-time new hire subclass so that those whose work site is in rating area 1 will be offered the traditional group health plan and those whose work site is in rating area 2 will continue to receive the HRA. Plan Sponsor F reasonably expects to employ 219 employees on January 1, 2025. As of January 1, 2025, Plan Sponsor F has 15 full-time employees whose work site is in rating area 2 and who were hired between January 1, 2022, and January 1, 2025.*

*(B) Conclusion. The same terms requirement of paragraph (c)(3) of this section is not satisfied in this paragraph (f)(2)(vii) (Example 7) because the new hire subclass has been subdivided in a manner that is subject to the minimum class size requirement, and the class offered the HRA fails to satisfy the minimum class size requirement. Specifically, once the new hire subclass is subdivided the general rules for applying the minimum class size requirement apply to the employees offered the HRA in the new hire subclass. In this case, because the subdivision of the new hire full-time subclass is based on rating areas; a class based on rating areas is an applicable class subject to the minimum class size requirement; and the employees in one rating area are to be offered the HRA, while the employees in the other rating area are offered the traditional group health plan, the minimum class size requirement would apply on and after the date of the subdivision. Further, the minimum class size requirement would not be satisfied, because the applicable class size minimum for Plan Sponsor F would be 20, and only 15 employees in rating area 2 would be offered the HRA.*

**REGULATION EXAMPLE OF NEW FULL-TIME EMPLOYEE CLASS  
SUBDIVIDED BASED ON STATE<sup>83</sup>**

*Example 8: New full-time employee class subdivided based on state--(A) Facts. The facts are the same as in paragraph (f)(2)(vii) of this section (Example 7), except that for the 2025 plan year, Plan Sponsor F intends to subdivide the new hire, full-time class so that those in State 1 will be offered the traditional group health plan and those in State 2 will each be offered an HRA on the same terms.*

*(B) Conclusion. The same terms requirement of paragraph (c)(3) of this section is satisfied in this paragraph (f)(2)(viii) (Example 8) because even though the new hire subclass has been subdivided, it has been subdivided in a manner that is not subject to the minimum class size requirement as the subdivision is based on the entire state.*

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<sup>82</sup> Reg. §54.9802-4(f)(2)

<sup>83</sup> Reg. §54.9802-4(f)(2)



**REGULATION EXAMPLE OF NEW FULL-TIME AND PART-TIME  
EMPLOYEES OFFERED HRA<sup>84</sup>**

*Example 9: New full-time employees and part-time employees offered HRA--(A) Facts. In 2021, Plan Sponsor G offers its full-time employees a traditional group health plan and does not offer coverage to its part-time employees. For the 2022 plan year, Plan Sponsor G offers its full-time employees hired on or after January 1, 2022, and all of its part-time employees, including those hired before January 1, 2022, and those hired on and after January 1, 2022, an HRA on the same terms, and it continues to offer its full-time employees hired before January 1, 2022, a traditional group health plan.*

*(B) Conclusion. The minimum class size requirement applies to the part-time employees offered the HRA in 2022 because the class is being offered an HRA; the special rule for new hires does not apply (because this class was not previously offered a traditional group health plan) and so it is not a new hire subclass exempt from the minimum class size requirement; another class of employees (that is, full-time hired before January 1, 2022) are being offered a traditional group health plan; and the part-time employee class is generally an applicable classes that is subject to the minimum class size requirement. However, because the full-time, new hire subclass is based on the special rule for new hires, the minimum class size requirement does not apply to full-time new hires offered an HRA in 2022.*

### Opt-Out Rule

A plan must provide that an employee must be eligible to opt-out of an individual coverage HRA at least annually if the HRA is either unaffordable or does not provide minimum value. The preamble notes that such individuals may benefit more from obtaining a premium tax credit (PTC) than participating in the HRA, but such a credit is not allowed to an employee covered by an HRA.<sup>85</sup> As well, employees must have the right to opt-out of HRA coverage upon termination of employment.<sup>86</sup>

### Substantiation Requirements

The plan must implement and comply with reasonable procedures to verify that covered individuals actually have a qualifying individual health care policy on an annual basis (the *annual coverage substantiation requirement*).<sup>87</sup> The plan will provide the date for substantiation each year, but it can be no later than the first day of the HRA plan year.<sup>88</sup> If an individual becomes eligible for an individual coverage HRA during the plan year or become eligible later than 90 days before the plan year begins, the date may be no later than the date HRA coverage begins, though the plan can specify an earlier date.<sup>89</sup>

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<sup>84</sup> Reg. §54.9802-4(f)(2)

<sup>85</sup> *Ibid*, pp. 98-99

<sup>86</sup> *Ibid*, p. 99, Reg. §54.9804-2(c)(4)

<sup>87</sup> *Ibid*, p. 102, Reg. §54.9804-2(c)(5)(i)

<sup>88</sup> *Ibid*, p. 103, Reg. §54.9804-2(c)(5)(i)

<sup>89</sup> *Ibid*, p. 104, Reg. §54.9804-2(c)(5)(i)

As well, with each reimbursement the participant must provide substantiation to the individual coverage HRA that the participant (and, if applicable, covered dependent) continues to be enrolled in individual health insurance for the month for which reimbursement is sought along with substantiation of the expense normally required for an HRA to issue a reimbursement.<sup>90</sup>

The substantiation for the annual coverage requirement can be verified by reasonable procedures implemented by the HRA. Such reasonable procedures include requiring the participant to provide either:

- A document from a third party (for example, the issuer or Exchange) showing that the participant and any dependent(s) covered by the individual coverage HRA are, or will be, enrolled in individual health insurance coverage during the plan year (for example, an insurance card or an explanation of benefits pertaining to the plan year or relevant month, as applicable);<sup>121</sup> or
- An attestation by the participant stating that the participant and any dependent(s) are, or will be, enrolled in individual health insurance coverage, the date coverage began or will begin, and the name of the provider of the coverage.<sup>91</sup>

For the ongoing substantiation required for each reimbursement paid, the HRA can rely upon a simple written attestation by the participant included on the reimbursement form.<sup>92</sup>

### Model Substantiation Documents

The Departments are providing a model attestations for these purposes, but HRAs are not required to use those specific forms.<sup>93</sup>

Here is the model annual coverage substantiation notice:

*Instructions: You have been offered an individual coverage health reimbursement arrangement (HRA) to help you pay for medical care expenses. To enroll in this individual coverage HRA, you must be enrolled in individual health insurance coverage, Medicare Part A (Hospital Insurance) and B (Medical Insurance), or Medicare Part C (Medicare Advantage). You should have received a notice that describes the individual coverage HRA that you are being offered. If you have not, or if you have questions about the individual coverage HRA, contact [add contact information].*

*If you plan to enroll in the individual coverage HRA, you must complete this form to confirm that you will have individual health insurance coverage, Medicare Part A and B, or Medicare Part C while you are covered by the*

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<sup>90</sup> *Ibid*, pp. 105-106, Reg. §54.9804-2(c)(5)(ii)

<sup>91</sup> *Ibid*, p. 107, Reg. §54.9804-2(c)(5)(i)

<sup>92</sup> *Ibid*, Reg. §54.9804-2(c)(5)(ii)

<sup>93</sup> IRS Website, “Health Reimbursement Arrangements,” <https://www.irs.gov/newsroom/health-reimbursement-arrangements-hras>, June 13, 2019, accessed June 14, 2019

## 28 Current Federal Tax Developments

*HRA. If your family members will also be covered by the individual coverage HRA, you need to fill out the applicable section of this form on their behalf.*

*You must sign and date the form. Your family members do not need to sign or date the form. Please return the completed form to [add instructions for returning the form]. You must return the form by [add deadline for returning the form.]*

*I attest to the following:*

*I, \_\_\_\_\_, am covered (or will be covered) by the following health coverage:*  
\_\_\_\_\_.

*This health coverage began (or will begin) on \_\_\_\_\_.*

*Instructions: Complete the following if you plan to enroll a family member in the individual coverage HRA. If more than one family member will be covered by the individual coverage HRA, fill out a form for each family member. [This section may also be copied to allow a participant to list all family members on a single form.]*

*The following family member, \_\_\_\_\_, is covered (or will be covered) by the following health coverage: \_\_\_\_\_.*

*This health coverage began (or will begin) on \_\_\_\_\_.*

*I hereby affirm that the above information is true and accurate.*

*Signed: \_\_\_\_\_*

*Date: \_\_\_\_\_*

The model ongoing substantiation notice is reproduced below:

*Instructions: To receive reimbursement for medical care expenses under your individual coverage health reimbursement arrangement (HRA), you must complete this form for each request for reimbursement.*

*The individual coverage HRA will reimburse you for a medical care expense incurred during a month only if you have (or had) individual health insurance coverage, Medicare Part A (Hospital Insurance) and B (Medical Insurance), or Medicare Part C (Medicare Advantage) during that month. Similarly, the individual coverage HRA will reimburse you for a medical care expense your family member incurred during a month only if the family member has (or had) individual health insurance coverage, Medicare Part A and B, or Medicare Part C during that month. In this form, you are attesting that you (or your family member) meet this requirement. [If this form is not combined with the form used to seek reimbursement of medical care expenses, add a statement that the reimbursement form is separate.]*

*You must sign and date this form. Your family member does not need to sign or date the form. Please return the completed form to [add instructions for returning the form, including any applicable deadline].*

*Complete the following if you're requesting reimbursement of your medical care expense from the individual coverage HRA.*

*I attest to the following:*

*I, \_\_\_\_\_, am requesting reimbursement for a medical care expense incurred during \_\_\_\_\_, and for that month I am (or was) covered under the following health coverage: \_\_\_\_\_.*



*Instructions: Complete the following if you're requesting reimbursement of a family member's medical care expense from the individual coverage HRA.*

I, \_\_\_\_\_, am requesting reimbursement for a medical care expense incurred by \_\_\_\_\_, during \_\_\_\_\_, and for that month this family member is (or was) covered under the following health coverage:

\_\_\_\_\_.

*I hereby affirm that the above information is true and accurate.*

*Signed:* \_\_\_\_\_

*Date:* \_\_\_\_\_

### **Reliance on Substantiation**

The HRA is allowed to rely upon the individual's attestation to coverage unless the HRA is or becomes aware the attestation is inaccurate. If the HRA subsequently becomes aware of an inaccurate attestation, the HRA may not provide further reimbursement on behalf of the individual for the period to which the attestation applies.<sup>94</sup>

### **Written Notice to Participants**

Due to the differences between individual coverage HRAs and traditional health care plans and the potential impact on qualification for both the advance premium tax credit (APTC) and the premium tax credit (PTC), the regulations require HRAs to provide a written notice to participants.<sup>95</sup>

The Departments are providing online on the IRS's HRA web page a six-page model notice that plans may provide to employees offered the HRA to satisfy portions of the requirement.<sup>96</sup>

The Notice is required to contain:

- A description of the terms of the individual coverage HRA (including the self-only maximum dollar amount made available, which is used in the affordability determination under the proposed PTC rules);
- Amounts available under the individual coverage HRA;
- A statement of the right of the participant to opt out of and waive future reimbursement under the HRA;
- A description of the potential availability of the PTC if the participant opts out of and waives the HRA and the HRA is not affordable under the proposed PTC rules;

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<sup>94</sup> TD 9867, [https://s3.amazonaws.com/public-inspection.federalregister.gov/2019-12571.pdf?utm\\_source=federalregister.gov&utm\\_medium=email&utm\\_campaign=pi+subscription+mailing+list](https://s3.amazonaws.com/public-inspection.federalregister.gov/2019-12571.pdf?utm_source=federalregister.gov&utm_medium=email&utm_campaign=pi+subscription+mailing+list), accessed on June 13, 2019, pp. 111-112, Reg. §54.9804-2(c)(5)(iii)

<sup>95</sup> *Ibid*, p. 114, Reg. §54.9802-4(c)(6)(i)

<sup>96</sup> IRS Website, "Health Reimbursement Arrangements," <https://www.irs.gov/newsroom/health-reimbursement-arrangements-hras>, June 13, 2019, accessed June 14, 2019

## 30 Current Federal Tax Developments

- A description of the PTC eligibility consequences for a participant who accepts the HRA;
- A statement that the participant must inform any Exchange to which they apply for APTC of certain relevant information;
- A statement that there are multiple types of HRAs and that the individual coverage HRA is not a QSEHRA;
- A statement that individual coverage HRAs may be integrated with Medicare;
- A statement in that notice that Medicare beneficiaries are ineligible for the PTC, without regard to whether the individual coverage HRA the individual is offered is affordable or provides MV or whether the individual accepts the HRA; and
- A statement about how the participant may find assistance for determining their individual coverage HRA affordability.<sup>97</sup>

In response to comments asking for certain additional information, the preamble notes that the individual coverage HRA must provide a summary of benefits and coverage, which would include a description of the coverage, including cost sharing; the exceptions reductions and limitations on coverage and other limitations per PHSA Section 2715(b)(3), incorporated in IRC §9815 and ERISA Section 715.<sup>98</sup>

### Timing of Notice to Participants

The notice must be provided to employees being offered the individual coverage HRA at least 90 days before the beginning of each plan year.<sup>99</sup> If the employee is not eligible to participate at the time the notice is required to be provided to employees (such as an employee that qualifies in the middle of the plan year), the notice must be provided to that employee no later than date on which the participant may first participate in the individual coverage HRA.<sup>100</sup> As well, if an individual coverage HRA is sponsored by an employer that itself is established less than 120 days before the beginning of the first plan year of HRA, the notice can be provided no later than the first date on which the HRA may first take effect for the participant for the first plan year.<sup>101</sup>

However, the regulations provide that, if possible, the HRA should provide the notice sooner.<sup>102</sup> The Department of Labor in other similar situations (such as for deposit of 401(k) funds withheld from paychecks) has taken the position that the sponsor needs to justify why it wasn't possible to give the notice sooner than the last day provided in the regulations, so

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<sup>97</sup> TD 9867, [https://s3.amazonaws.com/public-inspection.federalregister.gov/2019-12571.pdf?utm\\_source=federalregister.gov&utm\\_medium=email&utm\\_campaign=pi+subscription+mailing+list](https://s3.amazonaws.com/public-inspection.federalregister.gov/2019-12571.pdf?utm_source=federalregister.gov&utm_medium=email&utm_campaign=pi+subscription+mailing+list), accessed on June 13, 2019, pp. 115-116, 118, 120, Reg. §54-9802-4(c)(6)(ii)

<sup>98</sup> *Ibid*, p. 116-117

<sup>99</sup> *Ibid*, p. 121

<sup>100</sup> *Ibid*, pp. 121-122

<sup>101</sup> *Ibid*, p. 123

<sup>102</sup> *Ibid*, p. 124

sponsors should take the comment as more than a suggestion—ignoring that comment could prove costly should the Department of Labor investigate the employer.

The actual delivery of the notice must be handled in a manner reasonably calculated to insure the actual receipt of that material by the plan participant and those individual coverage HRAs subject to ERISA must comply with DOL rules on such notices.<sup>103</sup>

### Special Insurance Type Issues

Individual coverage HRAs may be integrated with student health care coverage that is exempt from certain provisions of PPACA and HIPAA.<sup>104</sup> However, individual coverage HRAs cannot be integrated with self-insured student health plans. HRAs will need to take additional steps to insure that if a student health plan is offered as the individual coverage, the coverage is being provided by insurance by a licensed issuer.<sup>105</sup>

Short-term limited duration insurance (STLDI), since it is not required to conform to the market requirements of PHSA sections 2711 and 2713, cannot be integrated with individual coverage HRAs.<sup>106</sup>

As well, an individual coverage HRA cannot be integrated with group insurance coverage provided by the employer of the spouse of the employee. While such coverage can be integrated with other HRAs maintained by the employer, the HRA cannot be used to pay for the coverage provided by the spouse's employer.<sup>107</sup>

Individual coverage HRA cannot be integrated with health care sharing ministries.<sup>108</sup>

TRICARE by itself cannot be integrated with an individual coverage HRA. However, if the employee also is enrolled in individual health coverage or Medicare, then the employee may enroll in an individual coverage HRA while maintaining TRICARE coverage.<sup>109</sup> The preamble goes on to note:

*Further, as explained later in this preamble, HRAs may reimburse medical care expenses and the HRA plan sponsor determines which medical care expenses a particular HRA may reimburse, consistent with the discussion later in this preamble. It may be the case that an HRA will be available to pay both the premiums and cost-sharing for individual health insurance coverage as well as any medical care expenses related to TRICARE, subject to the terms of the HRA.<sup>110</sup>*

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<sup>103</sup> *Ibid*, p. 125

<sup>104</sup> *Ibid*, p. 128, Reg. §54.9802-4(d)(6)

<sup>105</sup> *Ibid*, p. 129-130

<sup>106</sup> *Ibid*, p. 132-133

<sup>107</sup> *Ibid*, p. 134

<sup>108</sup> *Ibid*, p. 135

<sup>109</sup> *Ibid*, pp. 136-137

<sup>110</sup> *Ibid*

The final regulations explain the discretion the plan sponsor has in determining what expenses the individual coverage will cover:

*An HRA may provide for reimbursement of expenses for medical care, as defined under Code section 213(d). Consistent with the current rules that apply to HRAs generally, under the final rules, a plan sponsor has discretion to specify which medical care expenses are eligible for reimbursement from an individual coverage HRA it establishes. A plan sponsor may allow an HRA to reimburse all medical care expenses, may limit an HRA to allow reimbursements only for premiums, may limit an HRA to allow reimbursements only for non-premium medical care expenses (such as cost sharing), or may decide which particular medical care expenses will be reimbursable and which will not be reimbursable. However, in the latter case, the designation of the reimbursable expenses must not violate other rules applicable to group health plans, such as the HIPAA nondiscrimination rules or the MSP provisions. The final rules do not require that an individual coverage HRA be used (or be allowed to be used) for reimbursement of premiums for individual health insurance coverage (or Medicare). However, as detailed earlier in this preamble, the final rules require that individuals covered by an individual coverage HRA be enrolled in individual health insurance coverage (or Medicare). Thus, the Departments generally anticipate that employers will allow individual coverage HRAs to reimburse premiums for such coverage.<sup>111</sup>*

### Individual Coverage HRA and Health Savings Accounts (HSAs)

If the individual coverage HRA limits its reimbursements to paying for individual health insurance premiums and the participant uses those premiums to pay for a qualified high deductible health plan policy (HDHP), the mere existence of the HRA will not make the employee ineligible to establish a health savings account so long as all other requirements are met. The preamble points out that this result is in line with prior guidance provided in Q&A 1 of Notice 2008-59.<sup>112</sup> But if the individual coverage is allowed to be used to pay for other disqualifying expenses, even if the employee does not actually seek such reimbursement, the employee would not be eligible to contribute to an HSA. But the mere fact that the individual coverage HRA could be used to pay for non-HDHP coverage will not cause employees using the individual coverage HRA who use the funds to purchase an HDHP to lose the right to make contributions to the HSA.<sup>113</sup>

### Medicare Integration and Issues

An individual coverage HRA may be integrated with either individual health insurance coverage or Medicare Part A and B, or Part C. An individual coverage HRA can be used to reimburse premiums for Medicare and Medicare supplemental health insurance.<sup>114</sup>

The final regulations take into account an issue described in the preamble to the proposed regulations where, under laws and regulations applicable to Medicare, a group health plan is not able to discriminate against those eligible to participate in Medicare but such individuals would

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<sup>111</sup> *Ibid*, p. 138

<sup>112</sup> *Ibid*, p. 140

<sup>113</sup> *Ibid*, p. 141, Reg. §54-9802-4(c)(vi)

<sup>114</sup> *Ibid*, pp. 143-144, Reg. §54-9802-4(e)(1)

be unable to purchase individual health coverage due to the anti-duplication rule applicable to Medicare beneficiaries that prohibits the sale to those individuals of policies that duplicate Medicare benefits.<sup>115</sup>

To deal with this problem, the regulations permit individual coverage HRAs to be integrated with either individual health insurance coverage or Medicare for a participant enrolled in Medicare Part A and B (traditional pay for service Medicare) or Part C (generally Medicare offered via an HMO or PPO program). This is true even if the HRA is not subject to the Medicare Second Payor (MSP) provisions.<sup>116</sup>

The preamble notes one additional limitation on individual coverage HRA plans that involves Medicare:

*To ensure that an individual coverage HRA that is subject to the MSP provisions does not violate those rules, an individual coverage HRA may not, under its terms, limit reimbursement only to expenses not covered by Medicare, as HHS has determined this could amount to a group health plan taking into account entitlement to Medicare in violation of the MSP provisions. However, an individual coverage HRA may limit reimbursement to only premiums or nonpremium medical care expenses (such as cost sharing), or may decide which particular medical care expenses will be reimbursable and which will not be reimbursable under the terms of the HRA.<sup>117</sup>*

While individual policies purchased with individual coverage HRA funds will not subject the Medicare Second Payor rules since they are not group health plans, the individual coverage HRA is a group plan and will be subject to the MSP rules. HHS will issue guidance clarifying the primary vs. secondary payor responsibility of individual coverage HRAs for plan sponsors subject to the MSP provisions as well as the impact of the Medicare, Medicaid and SCHIP Extension Act of 2017 reporting requirements for such programs.<sup>118</sup>

### **Amounts Made Available Via Individual Coverage HRA**

The preamble notes that the regulations do not impose a limit on the amount of individual employer HRA funds made available to the employee. The Departments go on to suggest that employers who are subject to the large employer shared responsibility provisions under IRC §4980H may want to insure they offer a high enough HRA amount to avoid a potential shared responsibility payment.<sup>119</sup>

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<sup>115</sup> *Ibid*, pp. 147-148

<sup>116</sup> *Ibid*, pp. 149

<sup>117</sup> *Ibid*, p. 154

<sup>118</sup> *Ibid*, pp. 154-155

<sup>119</sup> *Ibid*, p. 156

### Excepted Benefit HRAs

The regulations also provide for a different category of HRAs known as *excepted benefit HRAs* which do not integrate with either group or individual health plans. Such HRAs:

- Must not be an integral part of the plan,
- Must provide benefits that are limited in amount,
- Cannot provide reimbursement for premiums for certain health insurance coverage, and
- Must be made available under the same terms to all similarly situated individuals.<sup>120</sup>

Note that the name of these HRA makes it easy to confuse them with HRAs that offer only excepted benefits as provided for in Notice 2015-87. The preamble explains the difference:

*As a general matter, some commenters expressed confusion and asked for clarification regarding the difference, if any, between the proposed excepted benefit HRA and an HRA that only reimburses expenses for excepted benefits. In IRS Notice 2015-87, Q&A-5, the Treasury Department and the IRS explained that an HRA or employer payment plan that, by its terms, reimburses (including paying directly for) premiums for individual health insurance coverage solely to the extent that the individual health insurance coverage covers excepted benefits would not fail to satisfy the market requirements because those requirements do not apply to a group health plan that is designed to provide only excepted benefits, either through reimbursement of premiums or cost sharing (referred to in this preamble as an HRA that provides only excepted benefits). Excepted benefit HRAs, on the other hand, can provide reimbursement for costs incurred related to coverage that is not limited to excepted benefits (for example, cost sharing for individual health insurance coverage).<sup>121</sup>*

The HRAs that only provide excepted benefits do not have to qualify under the rules for excepted benefit HRAs.<sup>122</sup> While we could have hoped for a less confusing name, advisers will need to remember that an *excepted benefit HRA* is a defined category of HRA with the emphasis that the HRA is excepted, while HRAs that *offer only excepted benefits* concentrates only that the benefits offered under the HRA are those that are considered *excepted benefits* under PPACA—most importantly, they are simply different things that are subject to very different rules—and *excepted benefit HRA* are the type that did not previously exist. And the excepted benefit HRA is itself a special class of excepted benefits.

The preamble goes on to explain how an excepted benefit HRA can satisfy the requirement that it not be an integral part of the employer's plan:

*To satisfy this condition, the proposed rules specified that other group health plan coverage (other than an account-based group health plan or coverage consisting solely of excepted benefits) must be made available by the same plan sponsor for the plan year to the participants offered the excepted benefit HRA. Only individuals eligible to participate in the traditional group health plan would be eligible to participate in the excepted benefit HRA. However, while the plan sponsor would be required to make an offer of a traditional group health plan, HRA participants (and their dependents) would not be*

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<sup>120</sup> *Ibid*, p. 164, Reg. §54.9831-1(c)(3)(viii)

<sup>121</sup> *Ibid*, p. 166

<sup>122</sup> *Ibid*, p. 166-167

*required to enroll in the traditional group health plan for the HRA to be an excepted benefit HRA. In the preamble to the proposed rules, the Departments noted that this provision is similar to the requirement that applies under the limited excepted benefits rules for health FSAs at 26 CFR 54.9831-1(c)(3)(v), 29 CFR 2590.732(c)(3)(v), and 45 CFR 146.145(b)(3)(v).<sup>123</sup>*

Under the PPACA, excepted benefits must be limited in amount. Thus the regulations provide:

*Accordingly, the Departments proposed that amounts newly made available for a plan year in an excepted benefit HRA may not exceed \$1,800, indexed for inflation for plan years beginning after December 31, 2020. For this purpose, inflation was defined in the proposed rules by reference to the Chained Consumer Price Index for All Urban Consumers, unadjusted (C-CPIU), published by DOL. Also, the Departments stated that the adjusted limit for plan years beginning in a particular calendar year would be published early in the fall of the prior calendar year.<sup>124</sup>*

To be an excepted benefit HRA, the HRA cannot reimburse:

- Reimburse premiums for Medicare Part B or D, individual health insurance coverage, or
- Coverage under a group health plan (other than COBRA or other group continuation coverage)

except for individual health coverage or group health plan coverage that consists solely of excepted benefits.<sup>125</sup>

Such programs will be allowed to reimburse short-term limited duration insurance (STLDI) premiums.<sup>126</sup> However, if five criteria are met, the Departments may restrict excepted benefit HRAs from reimbursing STLDI premiums for certain employers. The preamble provides the following description of these conditions:

*First, the restriction applies only to excepted benefit HRAs offered by small employers, as defined in PHS Act section 2791(e)(4), to respond to concerns by commenters about adverse selection in the small group market. Second, the restriction applies only in situations in which the other group health plan coverage offered by the small employer is either fully- insured or partially- insured. This focus on insured coverage again is designed to narrowly address the potential for adverse selection by small, insured employers that was identified by commenters. Third, the restriction applies only if the Secretary of HHS makes a finding, in consultation with the Secretaries of Labor and the Treasury, that the reimbursement of premiums for STLDI by excepted benefit HRAs in a state has caused significant harm to the small group market in the state that is the principal place of business of the small employer.*

*Fourth, this finding may be made only after submission of a written recommendation by the applicable state regulatory authority of such state, in the form and manner specified by HHS. The written recommendation must include evidence that the reimbursement of STLDI premiums by excepted benefit HRAs established by insured or partially- insured small employers in the state has caused significant*

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<sup>123</sup> *Ibid*, pp. 166-167

<sup>124</sup> *Ibid*, p. 171, Reg. §54.9831-1(c)(3)(viii)(B)

<sup>125</sup> *Ibid*, p. 178, Reg. §54.9831-1(c)(3)(viii)(C)

<sup>126</sup> *Ibid*



*barm to the state's small group market, including on small group market premiums. The evidence may include the State Insurance Commissioner's documented overall assessment of the small group market in the state. It may also include representations made by small group market issuers that an increase in the purchase of STLDI coverage by employees of small employers has caused issuers to increase premiums for small group market insurance, due to the issuers' reasonable belief about adverse selection. HHS will evaluate each recommendation on a case-by-case basis. Factors that HHS may consider in determining whether significant harm had occurred include, but are not limited to, the impact on issuers' presence in the small group market, whether there has been more than a de minimis increase in premiums in the small group market, enrollment declines in the small group market related to individuals purchasing STLDI, and changes to the health of the small group market risk pool.*

*Finally, the restriction (or discontinuance of the restriction) must be imposed by publication of a notice by the Secretary of HHS in the Federal Register and will be effective prospectively only, and with a reasonable time for plan sponsors to comply.<sup>127</sup>*

Excepted benefit HRAs must be made available under the same terms to all similarly situated individuals, regardless of any health factor.<sup>128</sup> The preamble goes on to state:

*Consistent with the approach outlined in the proposed rules, under the final rules, an excepted benefit HRA may not, for example, be offered only to employees who have cancer or fail a physical examination, just as the excepted benefit HRA may not be offered only to employees who are cancer-free or who pass a physical examination. Similarly, an employer may not make greater amounts available in an excepted benefit HRA for employees who have cancer or who fail a physical examination, just as an employer may not make greater amounts available in an excepted benefit HRA for employees who are cancer-free or who pass a physical examination.<sup>129</sup>*

### Individual Coverage HRAs and Excepted Benefit HRAs

Note that a sponsor cannot offer both an individual coverage HRA and an excepted benefit HRA to the same employee, since an excepted benefit HRA can only be offered if a traditional group health plan is offered to the employee, while an individual coverage HRA can only be offered to employees who are not offered a traditional group health plan.<sup>130</sup>

The regulations offer the following rules for determining the affordability of an HRA for purposes of the premium tax credit (PTC):

*The proposed rules provided that an individual coverage HRA is affordable for an employee and a related HRA individual for a month if the employee's required HRA contribution does not exceed 1/12 of the product of the employee's household income and the required contribution percentage (defined in 26 CFR 1.36B-2(c)(3)(v)(C)). The proposed rules defined an employee's required HRA contribution as the excess of: (1) the monthly premium for the lowest cost silver plan for self-only coverage available to the employee through the Exchange for the rating area in which the employee resides; over (2) the monthly self-only HRA amount provided by the employee's employer. The monthly*

<sup>127</sup> *Ibid*, p. 193-194

<sup>128</sup> *Ibid*, p. 186, Reg. §54.9831-1(c)(3)(viii)(D)

<sup>129</sup> *Ibid*, p. 187

<sup>130</sup> *Ibid*, p. 197



*self-only HRA amount was proposed to be the self-only HRA amount newly made available to the employee under the individual coverage HRA for the plan year, divided by the number of months in the plan year the individual coverage HRA is available to the employee.<sup>131</sup>*

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<sup>131</sup> *Ibid*, p. 203, Reg. §1.36B-2(c)(3)(i)(B)