E Benefits Administration

What Is A Health Reimbursement Arrangement, (HRA)?

Health Reimbursement Arrangement

HRAs have been referred to by many names over the last few years such as personal savings accounts, personal care accounts, defined contribution plans, or consumer-driven health care plans. The confusion ended in 2002, when the IRS finally issued guidelines for employer-provided medical reimbursement accounts and called it the Health Reimbursement Arrangement, or HRA.

HRA accounts can pay the same expenses as a Section 125 Medical Reimbursement Flexible Spending Account (FSA), however, unlike an FSA only employers can contribute to the HRA.

How Employers Utilize an HRA

Expenses not reimbursed by health insurance are one way employer groups are utilizing HRAs. With an HRA, the employer funds an account from which the employee is reimbursed for qualified medical expenses, such as co-pays, deductibles, vision care, prescriptions, long-term care, medical insurance, chiropractic care, and most dental expenses. Over-the-counter drugs that are medically necessary and are accompanied by a Doctor's Prescription may also be reimbursed through an HRA. Reimbursements are not taxed to the employee, and are deductible by the employer.

The most common use of an HRA is in combination with a High Deductible Health Coverage (HDHC) Plan. HRAs can enhance a company's benefit package while helping to contain costs and boost employee morale. For example, you can combine your HRA with a higher-deductible health insurance plan. The employer benefits from reduced insurance costs, but the effect to the employee is cushioned with an HRA.

Plan Design Flexibility

HRAs provide employers with a lot of flexibility in Plan design. Limits can be set on types of services reimbursed by an HRA. Amounts contributed to an HRA can be in a lump sum or in increments throughout the year. This is in contrast to a Section 125 Medical FSA where the employer can be liable for the full amount on the first day of the plan. You can also choose to carry over unused funds to the next plan year, or have all or a portion of the unused funds forfeited at the end of the year.

In contrast to the "use-it-or-lose-it" rule of cafeteria plans, the employee gets to carry forward any unused HRA account funds. Depending on the design options elected by the employer, their employees may request reimbursement for medical expenses at the time services are rendered, accumulate them for reimbursement in the future, or save the funds in the HRA for retiree health benefits.

Who Can Establish an HRA Plan

Sole Proprietors, partnerships, regular corporations, S corporations, limited liability companies (LLCs), professional corporations, and 501(c)3 not-for-profits can establish an HRA plan.

Individuals that can not personally participate in an HRA include sole proprietors, partners, members of an LLC (in most cases), or individuals owning more than 2% of an S corporation. Although these specific owners can not personally participate they can still sponsor an HRA and benefit from the write-off.

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Plan Design Options

There are numerous plan design issues employers may wish to consider as they design their HRA.

The Comprehensive Plan - The Comprehensive HRA can cover any out-of-pocket medical expense that include but are not limited to dental expenses, vision expenses, co-pays, deductibles, medical expenses and health insurance premiums. The Comprehensive Plan may or may not be coupled with a high deductible health coverage or limited-benefit medical plan.

The Limited HRA - A Limited HRA will cover only specified out-of-pocket medical expenses such as prescriptions, dental, vision etc. and can be restricted to cover just one medical expense.

The Premium Reimbursement Arrangement (PRA) Plan - The PRA allows employers to reimburse only health insurance premiums including group sponsored insurance plans as well as individual health insurance policies outside the group, or long-term care insurance.

The Deductible Gap - The Deductible Gap HRA is designed to be coupled with a High Deductible Health Coverage and will pay for only items covered by the insurance policy it compliments. The employer benefits from reduced insurance costs, but the effect to the employee is cushioned with the Deductible Gap HRA.

Important HRA Facts

HRA Carryover Provisions. HRAs with a carryover feature can be offered on a tax-favored basis if the following conditions are satisfied:

- The HRAs must be funded solely with employer contributions;
- If high deductible health coverage is coupled with the HRA, the employee portion of the premium (i.e. family coverage premium) can be paid with pre-tax-salary deductions, however, in no event can the HRA itself be funded with pre-tax salary deductions or through a cafeteria plan;
- The HRA can only reimburse substantiated medical care expenses incurred by employees and their spouses and dependents; and
- Unused portions cannot be cashed out, though terminated employees can spend down their HRA balances after they terminate.

HRAs are Health FSAs with subtle differences. Many health FSA rules do not apply to HRAs, for example, unlike an FSA, HRAs can reimburse insurance premiums. Also, the HRA period of coverage <u>is not</u> required to be 12 months, like an FSA. And, the FSA rule limiting reimbursement to expenses incurred during the current period of coverage does not apply. This means expenses incurred during the current year can be reimbursed in the subsequent year so long as the individual was a participant when the expense was incurred.

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HRAs Can Be Designed To Pay Last, After The Health FSA. Normally the health FSA must be the payer of last resort. Thus if an employee participates in both the HRA and a health FSA and they both cover the same expenses, the employee would first look to the HRA for payment increasing the likelihood the employee might have to forfeit unused health FSA funds. The good news is the IRS has authorized employers to design HRAs to require the health FSA to pay first, which will reduce health FSA forfeitures under the use-it-or-lose-it rule.

COBRA and HRAs. HRAs are generally subject to COBRA continuation coverage requirements unless the small employer exemption applies.

Nondiscrimination Rules and HRAs. HRAs can not discriminate in favor of highly compensated employees.

Prohibition on mid-year changes does not apply. The 12-month period of coverage and prohibition of mid year changes does not apply to an HRA.

Is a Trust Account Required? No trust is required if HRA reimbursements are made directly out of the general assets of the employer.

Are Account Earnings Taxable? This is not applicable if reimbursements are made directly out of the general assets of the employer. If the HRA is funded by a Voluntary Employee Beneficiary Association (VEBA) trust account, earnings are generally not taxable.

Form 5500 Reporting Requirement. Employer groups that cover more than 100 participants must file an IRS Form 5500 within seven months of the end of the plan year.

Plan Document Required. The Code requires that the plan be in writing and that every participant receives a Summary Plan Description, (SPD).