Washington Pulse

October 2019

New Guidance Simplifies Affordability Determination for ICHRAs

The IRS has issued proposed regulations that provide additional guidance to employers intending to offer an Individual Coverage HRA (ICHRA) for 2020 and beyond. The guidance confirms and clarifies the safe harbor provisions that were initially outlined in IRS Notice 2018-88. The proposed regulations are meant to 1) help employers determine whether their ICHRA is affordable, and 2) clarify the ICHRA nondiscrimination testing requirements.

Affordability

There are several reasons why an ICHRA may appeal to employers. For example, an ICHRA allows an employer to contribute a set amount to employees while reducing the employer's risk of incurring unknown costs that may arise with traditional group health insurance plans.

A unique feature of the ICHRA is that it is flexible: there are no minimum or maximum contribution limits, so an employer can contribute any amount it chooses. But there are some restrictions. For example, an applicable large employer (ALE) that offers ICHRAs to its full-time employees must ensure that it is offering an "affordable" ICHRA. If the ICHRA is not affordable, then the employer must make a shared responsibility payment under Internal Revenue Code Section (IRC Sec.) 4980H(b). The payment is determined on a month-by-month basis. The monthly penalty amount is 1/12 of $3,860 for each full-time employee who receives a premium tax credit (PTC).

An ALE is defined as an employer who had an average of 50 or more full-time employees (including full-time equivalent employees) during the preceding calendar year. If an ALE offers an ICHRA to part-time employees only, the ALE will not be subject to the IRC Sec. 4980H(b) penalty if the ICHRA is not affordable. (The ALE must still offer affordable health coverage to its full-time employees or it could owe a penalty under IRC Sec. 4980H(a) or (b).) If the employer is not classified as an ALE, it will not be subject to the IRC Sec. 4980H(b) penalty, regardless of whether the ICHRA is considered affordable for employees.

An ICHRA is considered affordable for full-time employees if the monthly premium for single coverage under the lowest-cost silver plan offered on the Exchange in their rating area (where the employee lives) minus the monthly allowance is less than 9.78 percent of their household income. (On average, silver plans pay 70 percent of the costs for benefits that the plan covers.)

Determining affordability on this basis is difficult for employers: they may not know an employee's household income and may not know where the employee currently lives. As a result, the IRS has provided safe harbors to ease the calculation for employers.

Safe Harbors

Instead of using individual employee calculations, employers may use the safe harbors when determining ICHRA affordability. Employers are not required to use *all* of the safe harbors when determining affordability. For example, employers could use the look-back month safe harbor and the affordability safe harbor, but disregard the location safe harbor when calculating affordability. Employers may also use the safe harbors when calculating affordability for all employees, or just when calculating affordability for a reasonable category of employees (as specified in the ICHRA final regulations). Employers must, however, always apply the safe harbors on a uniform and consistent basis for all the employees in a category.

Look-back month safe harbor

Although the ICHRA may appeal to some employers, there are a few drawbacks—including not knowing how much to contribute to an ICHRA. The Exchange generally does not determine premium costs until shortly before open enrollment begins on November 1 of each year. Employers must usually make benefit decisions well before this date. To help employers determine how much they will have to contribute before the beginning of the plan year, the IRS has developed the look-back safe harbor.

To determine the ICHRA's affordability for the current year, this safe harbor allows a calendar-year ICHRA to use the cost of the lowest-cost silver plan offered on the Exchange in the employee's rating area during January of the *prior* year (known as the look-back month). Employers maintaining noncalendar-year ICHRAs may also use this safe harbor, but the look-back month will be January of the *current* year.

Affordability safe harbor

When determining ICHRA affordability, employers must also take into account the employee's household income. Prior guidance on affordability calculations has recognized that employers will not have this information—and have permitted an employer to use either a safe harbor based on the employee's Form W-2 income, the employee's rate of pay, or the federal poverty line.

When looking at the affordability safe harbors, remember that ICHRAs are funded solely by employer contributions. The term "HRA employee contributions" refers to what employees must pay for their insurance premiums in addition to what the employer must provide as an ICHRA contribution.

Form W-2 wages safe harbor: Under the Form W-2 wages safe harbor, the ICHRA is deemed affordable if the required HRA contribution for the employee does not exceed 9.78 percent (subject to cost-of-living adjustments) of that employee's W-2 wages for the calendar year. This safe harbor allows an employer to use the employee's wages entered in Box 1 of Form W-2.

The proposed regulations state that employers should not add back any W-2 reductions under IRC Sec. 36B (e.g., 401(k) or IRC Sec. 125 cafeteria plan contributions). When determining affordability, employers may not use Form W-2 wages from a prior year. They must use the current calendar year Form W-2 wages when determining affordability. This will require the employer to project the W-2 wages for each employee at the beginning of the current calendar year. If this proves to be to administratively difficult for the employer, the employer can use either the rate-of-pay or the poverty-line safe harbor described below.

Rate-of-Pay safe harbor: Under the rate-of-pay safe harbor, the ICHRA is deemed affordable for a calendar month if the required HRA contribution for the employee does not exceed 9.78 percent (subject to cost-of-living adjustments) of an amount equal to 130 hours multiplied by the lesser of 1) the employee's hourly rate of pay as of the first day of the coverage period (generally the first day of the plan year), or 2) the employee's lowest hourly rate of pay during the calendar month.

> **Example:** If an employee earns $15 per hour, the employer should perform the following calculation.
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> $15 x 130 hours = $1,950
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> $1,950 x .0978 = $190.71
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> In this example, for the ICHRA to be deemed affordable, the required HRA contribution for the employee must be less than $190.71.

If the employee is paid on a salary basis, the ICHRA is still deemed affordable if the employee's required HRA contribution for the calendar month does not exceed 9.78 percent of the employee's monthly salary.

Federal poverty-line safe harbor: Under the federal poverty-line safe harbor, an applicable large employer member's offer of ICHRA coverage to an employee is treated as affordable if the employee's required ICHRA contribution for the calendar month does not exceed 9.78 percent of a monthly amount. This amount equals 1/12 of the federal poverty line for a single individual for the applicable calendar year.

Location safe harbor

When determining an ICHRA's affordability, an employer must use the lowest-cost silver plan in the employee's rating area. This requires the employer to know where the individual lives.

The IRS initially proposed a location-based safe harbor in Notice 2018-88, which allowed employers to use the employee's primary work location for the area of residence. The IRS received numerous suggestions on how to simplify the calculation for employers while ensuring that employees would not be disadvantaged if premium costs varied widely in a small geographical area that was composed of different rating areas.

The proposed regulations conclude that the employer may generally use the primary site of employment where the employee will be reasonably expected to perform services on the first day of the plan year. The proposed regulations also address issues related to employees that change worksites midyear, who regularly work from home or in other remote locations, or who work only remotely.

Nondiscrimination Testing

The proposed regulations also provide more information on nondiscrimination testing.

The guidance found under IRC Sec. 105(h) prohibits discrimination in relation to benefits, in both plan design and plan operation. To be nondiscriminatory in design, employers must provide uniform contributions to all participants, and amounts cannot vary based on age or length of service. If the plan fails this nondiscrimination requirement, the excess reimbursements become taxable to the highly compensated individuals (HCIs).

The ICHRA rules, however, provide certain exceptions to this nondiscrimination requirement. Contributions may increase based on the number of dependents covered and based on the participant's age—as long as the oldest participants do not receive an amount greater than three times what the youngest participants receive. An ICHRA that follows these exceptions within each class of employees (as specified in the ICHRA final regulations) will not fail to meet the requirement to provide nondiscriminatory benefits as a matter of plan design.

Even if an ICHRA follows these exceptions, it may still be considered discriminatory in operation. If an ICHRA is discriminatory in operation and too many HCIs use the maximum ICHRA benefit, the excess reimbursements will become taxable to the HCIs.

Employers that have a large number of older employees who are HCIs may be concerned about failing nondiscrimination testing in relation to plan operations. Limiting ICHRA reimbursements may be a practical solution to testing concerns. This is because HRAs that reimburse only for premium costs (and are not permitted to reimburse for other 213(d) medical expenses) are excluded from the testing requirements of IRC Sec. 105(h).

The Take Away
The proposed regulations are consistent with the President's goal of expanding HRAs in order to give employers and employees more options when purchasing health insurance. This guidance should simplify determining an ICHRA's affordability and help employers avoid the shared responsibility payment. In light of the new proposed regulations, it is clear that the IRS is expecting employers of all sizes—including ALEs—to use the new ICHRA.

Ascensus will closely monitor any new developments regarding this guidance. Visit ascensus.com for future updates.