



Health Reimbursement Arrangement (HRA)

What is a Health Reimbursement Arrangement?

In 2002, the IRS issued guidelines for employer-provided medical reimbursement accounts, calling it the Health Reimbursement Arrangement, or HRA. Previously, HRAs were identified as personal savings accounts, personal care accounts, defined contribution plans, or consumer-driven health care plans. HRA accounts can pay the same expenses as a Section 125 Medical Reimbursement Flexible Spending Account (FSA), however only employers can contribute to the HRA, unlike an FSA.

Who Can Establish a 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.

Who Cannot Establish a HRA Plan?

Individuals that cannot 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 cannot personally participate they can still sponsor an HRA and benefit from the write-off.

How Can Employers Capitalize a HRA?

Expenses not reimbursed by health insurance are one way employer groups are utilizing HRAs. With an HRA, the employer funds an account with 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 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.

What Flexibility Do Employers Have in a HRA Plan Design?

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.



HRA Plan Design Options

There are several 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.

HRA Essential 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, if 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 is not required to be 12 months, like an FSA. Also, 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.

HRAs Can Be Designed To Pay Last, After the Health FSA

Normally the health FSA must be the payer of the 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, with will reduce health FSA forfeitures under the use-it-or-lose-it rule.



HRA Essential Facts Continued

COBRA & HRAs

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

Nondiscrimination Rules and HRAs

HRAs cannot 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, not by the Code, but possibly by ERISA (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 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).



Savings Calculator HRA Group Insurance Premium

Employers are now utilizing a new strategy combining high deductible health insurance with a HRA plans to significantly trim insurance costs. The effect to the employee is reduced with an HRA. See how much this new strategy could save your company.

The HRA concept is straightforward; the employer considers using a high deductible group health insurance plan to reduce premiums and save money. To ease the effect of the new high deductible to employees the employer establishes an HRA plan to pay the difference between the old deductible and the new high deductible. The HRA only pays if an employee actually has deductible expenses during the year. Actuaries say 15% to 20% of employees will have a deductible expense each year.

Example: The group's old health plan had a \$500 deductible. To save money the employer buys a \$5,000 deductible plan. The employer then establishes a HRA plan that will pay deductibles expenses from \$501 to \$5,000. The employee continues to pay the first \$500 of deductible expenses so nothing changes for the employee.

Here is an easy HRA savings calculator to determine if this concept will benefit your group:

Current / Old Group Insurance Premium:	\$ _____	A
New High Deductible Group Premium:	\$ _____	B
Group Premium Savings with HRA (A – B):	\$ _____	C
100% HRA Claim Liability for All Employees:	\$ _____	D
Anticipated HRA Claims at 20% (D x 0.20):	\$ _____	E
Premium Savings after HRA Claims (C – E):	\$ _____	F

Description:

A - Group's Current Health Insurance Premium without an HRA

B - Quote for New High Deductible Health Plan

C - Difference between the Old Premium and the Less Expensive New Premium

D - Potential liability if every employee had a 100% claim against the HRA.

For example: The HRA has a \$4,500 benefit per employee (\$501 to \$5000). There are 12 employees in the HRA plan, 12 employees x \$4,500 maximum HRA Benefit = \$54,000.

E - HRA actuarial anticipated claims based on the average group. Using 20% for first year calculations, after a group has one year of experience the group can estimate potential claims using their actual experience with most likely be less than 20%.

For example: If your total HRA plan liability if every employee had a 100% claim the total is \$54,000, multiply the total by 20% equals the expected claims expense for the HRA plan.

F - Net HRA savings to the group. Taking the total insurance premium savings in C and deduct the expected HRA claim number in E equals the expected annual savings.