QSEHRA Explained

Smart Choices Health
Creative Employee Benefit Strategies

Qualified small employer health reimbursement arrangements (QSEHRAs) allow small employers that do not have a group health plan to reimburse employees for health insurance premiums and other medical expenses on a tax-advantaged basis.

Eligible employers

To sponsor a QSEHRA, an employer must be a small employer that had, on average, less than 50 full-time and full-time equivalent employees in the prior calendar year. For purposes of determining the 50-employee threshold, aggregation rules apply to combine companies that have common owners or services.

In addition, the employer (including any other companies aggregated with the employer) must not offer its employees any of the following:

- A group health plan
- A group vision or dental plan
- A health reimbursement arrangement (HRA), or
- A health flexible spending arrangement (FSA)

Eligible employees

In general, all employees must be eligible for the QSEHRA; however, retirees, former employees, and non-employee owners are not eligible to participate. An employer can choose to exclude any of the following employees:

- Employees who have not completed 90 days of service,
- Employees under age 25 at the beginning of the plan year,
- Part-time employees who normally work less than 25 hours per week, although this threshold can be adjusted to 35 hours per week if other employees in similar work have substantially more hours,
- Seasonal employees who normally work less than 7 months a year, although this threshold can be adjusted to 9 months a year if other employees in similar work have substantially more months,
- Union employees if health benefits were the subject of good faith bargaining, and

- Employees who are nonresident aliens with no US earned income.

QSEHRA terms

A QSEHRA must be provided on the same terms to all eligible employees of the employer. In addition, it must be offered on the same terms to the employees of any other company that is required to be aggregated with the employer.
The QSEHRA can meet this "same terms" requirement even if an employer's reimbursement limit varies based on the cost of health insurance. Thus, an employer can provide a greater reimbursement to employees who are older or are covering multiple family members if they have a higher health insurance cost.
There are annual dollar limits on the reimbursements which can be made from a QSEHRA. These limits are adjusted each year for inflation and are prorated for employees participating in the QSEHRA for less than 12 months of the calendar year.

A QSEHRA may use the dollar amounts for the immediately preceding year to determine the limits for the current year. Fiscal year QSEHRAs can either (1) prorate the dollar limits based on the number of months in each portion of the two calendar years, or (2) use the dollar limits in effect on the first day of the plan year for the entire year.

A QSEHRA can be established at any time during the calendar year and can have a short initial plan year. The annual dollar limits are prorated by month to determine the limits for the short plan year.
A QSEHRA may allow carryovers of unused amounts from year to year; however, the employees' carryover amount plus the permitted benefit amount for the current year cannot exceed the dollar limit for the current year.

Example

The QSEHRA provides an annual permitted benefit of $5,000 and allows carryovers of unused amounts. Jane, who has self-only coverage, receives $3,000 in reimbursements from the QSEHRA for 2022, leaving a carryover amount of $2,000. In 2023, Jane would have a balance of $7,000 ($2,000 carryover plus $5,000 2023 permitted benefit); however, since her balance exceeds the 2023 self-only coverage limit of $5,850, it is reduced to the $5,850 limit.

If an employee is mistakenly given a reimbursement from a QSEHRA in excess of the annual dollar limit, the employee must repay the excess by March 15 of the following year.

Written notice

Employers that provide a QSEHRA to their employees must give the eligible employees an annual written notice at least 90 days in advance of the plan year. Employees who become eligible for the QSEHRA during the year must be given the notice by the first day they are eligible to participate in the QSEHRA. Failure to provide the notice can trigger a penalty on the employer of $50 per employee, up to $2,500 per year.

The written notice given to an employee must include the following information:

- The dollar amount of permitted benefit for that employee, or enough information for the employee to calculate the dollar amount.
- The date on which the employee is eligible for the QSEHRA.
- A statement that the employee must inform the Health Insurance Marketplace of the dollar amount of the permitted benefit he or she would receive under the QSEHRA, if the employee purchased health insurance through the Marketplace with advance premium tax credits.
- A statement that if the employee does not have health insurance that qualifies as minimum essential coverage for a month, that the employee may be liable for a shared responsibility payment for the month, and that the reimbursements under the QSEHRA for expenses incurred in the month will be includible in gross income.

Minimum essential coverage

A QSEHRA may only reimburse employees after they provide proof that they have health insurance that qualifies as minimum essential coverage. Proof of coverage must also be provided for any family member whose expenses will be reimbursed by the QSEHRA. The proof of coverage must be provided at least annually; however, before receiving each reimbursement during a plan year the employee must attest that the employee and family members have minimum essential coverage.
The proof must be:

- An insurance card, an explanation of benefits (EOB) or other document from a third party (such as an insurance company) showing coverage, plus an attestation by the employee that the coverage is minimum essential coverage; or
- An attestation by the employee stating that the coverage is minimum essential coverage, the date coverage began, and the name of the provider of the coverage.

Appendix A of Notice 2017-67 includes a list of minimum essential coverages and Appendix B provides model attestation language.

Substantiation

Employees seeking reimbursement from the QSEHRA must provide documentation to substantiate their medical expenses. Failure to do so adversely impacts every employee participating in the QSEHRA.

If the QSEHRA reimburses an employee for a medical expense that has not been substantiated, all reimbursements to all employees on or after that date become taxable, even if substantiated. The same result occurs if the expense reimbursed was not a valid medical expense. However, if the employee repays the QSEHRA or provides substantiation by March 15 of the following year, the QSEHRA reimbursements for all employees are excluded from taxable income.

Reimbursement of medical expenses

In general, the QSEHRA can reimburse the substantiated medical expenses of eligible employees and their family members on a tax-free basis. Eligible medical expenses include health insurance premiums and medical costs not covered by insurance, such as deductibles and copays. However, if a QSEHRA reimburses the following two types of expenses, the reimbursement will be taxable income to the employee: (1) premiums paid to a spouse's employer's plan via pretax deductions from the spouse's pay, and (2) over-the-counter drugs purchased without a prescription.

The employer can design the QSEHRA to make reimbursements available ratably on a month-by-month basis rather than making the full amount of the annual permitted benefit available at the beginning of the year. For example, if the annual permitted benefit is $2,400 ($200 per month) and an employee submits a $600 expense on the second day of the plan year, the employer could reimburse that expense by paying $200 a month for three months rather than $600 as a lump-sum.

The employer may also establish a time frame after the end of the plan year in which employees can submit claims for the plan year. This time frame is typically called a run-out period, and it must be provided on a uniform and consistent basis to all eligible employees.

Form W-2 reporting

QSEHRA benefits are required to be reported on Form W-2 in box 12 using code FF. Employers must report the dollar amount of reimbursements that each employee is entitled to receive from the QSEHRA, without regard to the number of reimbursements actually received.

Carryover amounts are not included on the Form W-2 for subsequent years. For example, if a QSEHRA provides a permitted benefit of $3,000 in 2023, and an employee receives reimbursements of $2,000, the 2023 Form W-2 will report $3,000. The $1,000 carryover to 2024 would not be reported on the 2024 Form W-2. Employers with fiscal year plans report the prorated amount of the permitted benefit for the calendar year.

QSEHRA reimbursements for over-the-counter drugs purchased without a prescription and premiums paid on a pre-tax basis for coverage under a group health plan sponsored by the employer of the employee's spouse are taxable income to the employee. They are reported as taxable wages on Form W-2 in box 1, plus are included in Social Security, Medicare, and FUTA wages. The fact that a portion of the QSEHRA permitted benefit is a taxable reimbursement does not change the amount reported on Form W-2 in box 12 using code FF.

Other QSEHRA considerations

Here are other QSEHRA considerations:

- Employees who purchase health insurance through the Marketplace may receive a smaller premium tax credit toward the cost of that insurance due to their participation in a QSEHRA.
- Employees participating in a QSEHRA that reimburses medical expenses other than insurance premiums will not be eligible to make health savings account (HSA) contributions. However, if the QSEHRA only reimburses insurance premiums and no other medical expenses, HSA eligibility is maintained.
- Employers sponsoring a QSEHRA must file Form 720, Quarterly Federal Excise Tax Return, by July 31 of the following year to report and pay the annual PCORI Fee.

Failure to satisfy the QSEHRA requirements

A QSEHRA arrangement will trigger an excise tax on the employer of $100 per affected person per day if:

- It is provided by an ineligible employer,
- It is not provided on the same terms to all eligible employees,
- It reimburses medical expenses without first requiring proof of minimum essential coverage, or
- It provides a permitted benefit more than the dollar limits.

Summary

Small employers can use QSEHRAs to reimburse employees for health insurance premiums and expenses on a tax-advantaged basis. Alternatively, small employers can adopt different HRAs that may better suit their needs such as a Individual Coverage Health Reimbursement Arrangement (ICHRA).