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## **B. HRAs May Reimburse Only Code §213(d) Expenses**

### **1. Out-of-Pocket Medical Expenses May Be Reimbursed by an HRA**

#### **a. Code §213(d) Medical Expenses**

An HRA may reimburse only medical care expenses as defined in Code §213(d). **1** But not all such medical care expenses are reimbursable. For example, as discussed later in this subsection, Code §106(c) prevents an HRA from reimbursing qualified long-term care expenses if the HRA falls within that section's definition of a "flexible spending arrangement." In addition, as a result of the health care reform law, **2** expenses incurred for medicines or drugs (other than insulin) with respect to taxable years beginning after December 31, 2010, are subject to an additional requirement. Those expenses may be reimbursed on a tax-free basis by an HRA only if the medicine or drug is prescribed, even if the medicine or drug is an over-the-counter (OTC) medicine or drug that may be purchased without a prescription. **3** For purposes of the new restrictions, a prescription for a medicine or drug must be a written or electronic order that satisfies the legal requirements for a prescription in that state (including that it be issued by someone authorized to issue prescriptions in that state). The restrictions do not apply to OTC items other than medicines and drugs (e.g., equipment, supplies, and medical devices, including items such as crutches, bandages, blood sugar test kits, and eyeglasses). **4**

#### **May an HRA Be Used to Pay Medical Expenses That Are Incurred Outside the United States?**

Andrew is traveling overseas, and he undergoes a procedure in a foreign hospital. May he use his HRA account to pay for this procedure? There is no requirement that medical expenses be incurred within the United States to qualify as a medical care expense within the meaning of Code §213(d).<sup>\*</sup> Thus, while there is no IRS guidance explicitly addressing this question, we believe that-if the expense that Andrew incurred also meets any other applicable requirements for reimbursement from his HRA-he should be able to pay for the expense from his HRA account on a tax-free basis.

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\* The travel expense requirements of Code §213(d) also are not limited to domestic travel.

## **b. Comparison to Health FSA Reimbursable Expenses**

The out-of-pocket medical expenses that may be reimbursed by an HRA-both before and after health care reform-are generally the same as those that may be reimbursed by a health FSA under a cafeteria plan. **5** Reimbursable expenses under HRAs and health FSAs include co-pays, deductibles, and medical expenses that are not covered by the employer's major medical plan. For general guidance on what expenses can be reimbursed by an HRA, see our analogous discussion of "What Expenses Can Be Reimbursed Under a Health FSA" in Section XX of *Cafeteria Plans* (Thomson Reuters/EBIA, 1991-present, updated quarterly). But note that certain subsections of Section XX of *Cafeteria Plans* apply only to health FSAs and are not applicable to HRAs. For example, a health FSA is subject to a 12-month uniform coverage requirement, while an HRA is not. And the prohibition on reimbursing qualified long-term care expenses does not apply to an HRA if it is not also an FSAs as defined by Code §106(c). (See Section XXI.C for a detailed discussion of the cafeteria plan rules that do not apply to HRAs.)

Code §106(c) defines an FSA as a benefit program offering coverage that reimburses specified incurred expenses and has a reasonably available maximum reimbursement that is less than 500% of the value of the coverage. **6** To the extent that an HRA is an FSA under this definition-and many HRAs are-it cannot reimburse expenses for qualified long-term care services as defined in Code §7702B, **7** even though such expenses are deductible under Code §213(d). **8** This provision appears to have been added to ensure that individuals who receive tax-free reimbursement of expenses under a long-term care insurance policy cannot also be reimbursed (on a tax-free basis) by an FSA (including an HRA that qualifies as an FSA under the 500% rule).

A long-term care expense is a "qualified" long-term care expense (and thus ineligible for reimbursement under an FSA) only if, among other things, a licensed health care practitioner certifies that the individual is "chronically ill." In the absence of such certification, it appears that long-term care services may be an eligible HRA expense-even for HRAs that are also FSAs. For further guidance on the interrelationship between long-term care expenses and FSAs, see our discussion of long-term care expenses in Section XX.L of *Cafeteria Plans* (Thomson Reuters/EBIA, 1991-present, updated quarterly).

**May an HRA Reimburse Expenses for Long-Term Care Services?** While there is no IRS guidance explicitly addressing this question, we believe the answer is yes, unless the HRA is also an FSA and the expenses were incurred by an individual who is certified as "chronically ill."<sup>\*</sup> Unfortunately, because the application of the definition of FSA under Code §106 is not entirely clear-and it can be difficult to prove that an individual has not been certified as chronically ill-there is some risk in permitting any HRA to reimburse expenses for qualified long-term care services. HRA administrators may want to eliminate

that risk by excluding such expenses entirely, or to reduce the risk by implementing administrative safeguards that prevent reimbursement of qualified long-term care expenses (e.g., patient certification that the expenses have not been incurred by a person who is "certified as chronically ill" or otherwise covered under a long-term care policy).

\* We note that proposed cafeteria plan regulations issued in 2007 simply state that a health FSA is not permitted to reimburse expenses "for long-term care services"-i.e., they make no distinction between qualified and nonqualified long-term care expenses. Prop. Treas. Reg. §125-5(k)(4). But it is unclear whether the failure to limit that prohibition to qualified long-term care expenses was intentional and-even if it were intentional-whether the IRS would ever seek to apply the same broad rule to HRAs.

#### **Are HRAs That Are FSAs Subject to the Health Care Reform Dollar Limit on FSA Contributions?**

No. Health care reform imposes a \$2,500 limit on annual salary reduction contributions to health FSAs offered under cafeteria plans, effective for taxable years beginning after December 31, 2012. \* HRAs cannot be funded with salary reduction contributions, so the \$2,500 limit rule does not apply to HRAs.

\* Code §125(i), as amended by PPACA, Pub. L. No. 111-148 (2010) and HCERA, Pub. L. No. 111-152 (2010). For the effective date of this provision, see PPACA, Pub. L. No. 111-148, §10902(b) (2010), as amended by HCERA, Pub. L. No. 111-152, §1403(a) (2010).

### **c. Can an HRA Cover More Than the Underlying Health Coverage?**

The revenue ruling that forms part of the 2002 IRS guidance [9](#) addresses two fact patterns, both of which involve an HRA that limits reimbursements to expenses that would have been covered but for the limitations imposed by the major medical plan (e.g., deductibles and amounts over what is "reasonable and customary").

The separate IRS notice that also forms part of the 2002 IRS guidance [10](#) defines an HRA much more broadly and would permit the reimbursement of any otherwise unreimbursed Code §213(d) medical expenses (subject to the limitations described below) whether covered by the medical plan or not. [11](#) Although it is not clear why the revenue ruling did not address a broader set of eligible medical expenses, it does not appear that the intent was to limit the HRA in scope to expenses that would otherwise be covered under the major medical plan but for its deductibles or limits. Treasury officials have informally indicated that the HRA coverage need not be co-extensive with the underlying health coverage-e.g., Lasik or other unreimbursed health expenses not covered under the primary health plan may qualify. Recent guidance on integrating HRAs affirms this principle by offering two options: (1) an integration method for plans that do not provide minimum value that must limit reimbursement to co-payments, co-insurance, deductibles, and premiums under the integrated coverage, as well as medical care that does not constitute essential health benefits; and (2) an integration method for plans

providing minimum value that imposes no reimbursement restrictions and thus allows reimbursement of any qualifying medical expense. (Qualified medical expenses are discussed in Section XXIV.B.) Even employers using the method for plans providing minimum value, however, may decide to limit the eligible expenses-by plan design-to reduce their coverage exposure (and adverse selection risk under COBRA). (For more on the two integration methods, see Section XXI.B.)

## 2. Health Insurance Premiums May Be Reimbursed by an HRA, but Caution Is Advised Due to HIPAA and Other Compliance Concerns

Unlike a traditional health FSA, an HRA may also provide reimbursement for "premiums for accident or health coverage for current employees, retirees, and COBRA qualified beneficiaries." [12](#)

It is important to note that the category of health insurance premiums that may be deductible under Code §213 (and hence reimbursable by HRAs) is limited to premiums-

for insurance (including amounts paid as premiums under part B of title XVIII of the Social Security Act, relating to supplementary medical insurance for the aged) covering medical care referred to in [Code §§213(d)(1)] (A) and (B) or for any qualified long-term care insurance contract (as defined in [Code §] 7702B(b)). [13](#)

This Code §213(d) category is narrower than the category of "accident or health coverage" that is excludable from an employee's income as employer-provided coverage under Code §106. For example, premiums for long-term disability insurance coverage would not qualify for reimbursement under an HRA.

While qualified long-term care insurance premiums are generally deductible, the deduction is limited. [14](#) Only the premiums paid during a taxable year that do not exceed the indexed annual limit (i.e., "eligible long-term care premiums") are deductible and eligible for reimbursement under an HRA. Eligible long-term care premiums should be reimbursable even if the HRA is an FSA and subject to the FSA prohibition on reimbursing qualified long-term care expenses (discussed earlier in this Section). [15](#)

**May a Limited-Purpose HRA Only Pay for HDHP Premiums?** Could an employer make contributions to a limited-purpose HRA that only reimbursed employees for their share of HDHP premiums? Would an employee who participated in such an HRA be eligible for an HSA? As discussed in subsection A, an HRA could not be used for this purpose if the employee could pay his or her share of the HDHP premium on a pre-tax basis under the employer's cafeteria plan. And, as noted below, several potential compliance issues may arise under HIPAA and COBRA where an employer allows an HRA to reimburse health insurance premiums (e.g., for an HDHP). It also raises compliance issues under health care reform's annual limit prohibition. (See Section XXI.B. Those issues could be resolved, however, if the

HRA and HDHP were integrated.) Setting aside these compliance issues for the moment, it may be that a limited-purpose HRA designed solely to reimburse HDHP premiums may not adversely affect HSA eligibility. The IRS has informally indicated that it will address this issue in guidance.\*

\* Informal, nonbinding remarks of Harry Beker, IRS, Office of Chief Counsel, Mar. 9, 2007 ECFC Annual Conference.

Also, as discussed in subsection A, an HRA cannot be used to pay the employee's share of premiums for employer group health coverage if the employee could pay those costs on a pre-tax basis through the employer's cafeteria plan. Such an arrangement would violate the prohibition on HRAs being directly or indirectly funded through cafeteria plan pre-tax salary reductions.

**May an HRA Pay for Fixed-Indemnity Cancer or Hospital Indemnity Insurance Coverage? No.**

Only premiums that qualify as a medical expense under Code §213(d) can be an eligible expense under an HRA. The IRS has ruled that fixed-indemnity type policies generally do not qualify as Code §213 deductible medical coverage.\*

\* Rev. Rul. 68-451, 1968-2 C.B. 111. Note that in 1999, the IRS ruled that fixed-indemnity type policies were accident and health policies under Code §106. Tech. Adv. Mem. 199936046 (May 19, 1999). As a result, even though premiums for an individual fixed-indemnity policy may not be reimbursed under an HRA, an employer may permit employees to pay for their fixed-indemnity cancer or hospital insurance policy with pre-tax salary reductions under the employer's cafeteria plan.

**Warning: Allowing HRA to Reimburse Health Insurance Premiums Raises HIPAA (and Other)**

**Concerns.** Although HRA plan sponsors may permit their HRAs to reimburse health insurance premiums under the 2002 IRS guidance, plan sponsors should be cautious in doing so. Additional compliance issues might arise, including the following: (a) inclusion of major medical coverage as an eligible HRA expense raises HIPAA nondiscrimination issues; (b) allowing an HRA to reimburse COBRA premiums could cause additional adverse selection (under the employer's own plan) or other COBRA difficulties; (c) premium costs that are reimbursable by the HRA must not be eligible for payment on a pre-tax basis under the employer's cafeteria plan; and (d) individual policy coverage cannot be used to satisfy the integrated plan exception to health care reform's prohibition on annual and lifetime limits, so reimbursements for such coverage will generally need to be limited to retiree-only plans and plans providing only excepted benefits. Additional compliance issues may arise under other laws. For example, we believe that an HRA that reimburses active employees' Medicare premiums (e.g., Medicare Part A, B, or D) most likely would be an impermissible incentive that would violate the Medicare Secondary Payer (MSP) requirements. HIPAA, COBRA, and other compliance issues are discussed in more detail in Section XXV. The annual and lifetime limits are discussed in Section XXI.B. See also the discussion of individual policy issues in Section X of *Cafeteria Plans* (Thomson Reuters/EBIA,

1991-present, updated quarterly), which explores the question, "Should employees be permitted to pay for individual insurance policies under a cafeteria plan?" Many of the issues discussed in Section X of *Cafeteria Plans* also apply to HRAs. See also the discussion of the MSP requirements in *Group Health Plans: Federal Mandates Other Than COBRA & HIPAA* (Thomson Reuters/EBIA, 2002-present, updated quarterly).

Treasury officials have informally indicated that eligible health insurance coverage of a spouse or tax dependent may qualify for HRA reimbursement as well-even if such coverage does not cover the employee. **16** Due to limitations under Code §106, and the potential of "pyramiding" COBRA obligations (discussed in Section XXV), employers that decide to reimburse insurance premiums through an HRA (notwithstanding the HIPAA and other issues mentioned above) may wish to limit reimbursement of premiums to health insurance coverage that is in the employee's/participant's name or that covers the employee/participant as a dependent.

### 3. Administrative Costs

The 2002 IRS guidance also specifically allows an HRA to fund administrative costs to maintain HRA coverage for retirees or others after termination of employment. The plan may also provide that the maximum reimbursement amount available after retirement or other termination of employment is reduced for any administrative costs of continuing such coverage. **17**

The administrative costs must be reasonable. **18** Presumably, such costs (e.g., a monthly maintenance fee) would be debited from the HRA account, and such a practice would not disqualify the HRA or cause retirees or other terminated employees to be taxed on the amounts so debited (or on the reimbursements paid by the HRA for medical expenses).

Note that Treasury officials have informally indicated that it is permissible for an HRA to fund administrative costs to maintain HRA coverage for active employees as well. **19**

**1** IRS Notice 2002-45, 2002-28 I.R.B. 93.

**2** Patient Protection and Affordable Care Act, Pub. L. No. 111-148 (2010) (PPACA), as amended by Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152 (2010) (HCERA).

**3** Code §106(f), as amended by PPACA, Pub. L. No. 111-148 (2010).

**4** IRS Notice 2010-59, 2010-39 I.R.B. 396.

**5** As noted in the next subsection, there are significant differences between HRAs and health FSAs in their ability to reimburse health insurance premiums, which are Code §213(d) expenses but are not considered out-of-pocket expenses.

**6** In a different context, COBRA premium assistance, the IRS offered the following interpretation of the 500% rule as applied to HRAs: "For this purpose, the maximum amount of reimbursement which is reasonably available is generally the balance of the HRA and the value of the HRA coverage would generally be the applicable premium for COBRA continuation of the HRA coverage." IRS Notice 2009-29, Q/A-37, 2009-16 I.R.B. 838.

**7** Code §7702B(c)(1) generally defines qualified long-term care services as "necessary diagnostic, preventive, therapeutic, curing, treating, mitigating, and rehabilitative services, and maintenance or personal care services, which-(A) are required by a chronically ill individual, and (B) are provided pursuant to a plan of care prescribed by a licensed health care practitioner." *See also Estate of Baral v. Comm'r*, 137 T.C. 1 (2011) and IRS Information Letter 2009-0010 (Dec. 18, 2008) (explaining these requirements in more detail).

**8** Code §106(c)(1) (gross income includes coverage for qualified long-term care services provided through an FSA or similar arrangement); Code §213(d)(1)(C) (the term medical care includes amounts paid for qualified long-term care services as defined in Code §7702B(c)).

**9** Rev. Rul. 2002-41, 2002-28 I.R.B. 75.

**10** IRS Notice 2002-45, 2002-28 I.R.B. 93, Part I.

**11** Note: This statement in the 2002 IRS guidance predates, and thus does not reflect, health care reform, which permits tax-free reimbursement of medicine or drug expenses incurred with respect to taxable years after December 31, 2010, only if the medicines or drugs are prescribed (whether or not the medicines or drugs may be obtained without a prescription). Code §106(f), as amended by PPACA, Pub. L. No. 111-148 (2010) (applies "for purposes of this section [106] and section 105").

**12** IRS Notice 2002-45, 2002-28 I.R.B. 93, Part II.

**13** Code §213(d)(1)(D).

**14** Code §213(d)(10). For a table showing the applicable limits, which depend upon the individual's attained age before the close of the taxable year, see Section XV.C.

**15** Treasury officials have informally indicated that long-term care premiums may be funded from an HRA even if the HRA is an FSA under the 500% rule, notwithstanding the Code §106 prohibition on paying for long-term care services from an FSA. Informal, nonbinding remarks of Kevin Knopf, Treasury Department, Office of Benefits Counsel, July 11, 2002 ECFC Conference.

**16** Informal, nonbinding remarks of Kevin Knopf (Treasury Department Office of Benefits Counsel), July 11, 2002 ECFC Conference.

**17** IRS Notice 2002-45, 2002-28 I.R.B. 93, Part III.

**18** The HRA sponsor must be able to prove that the amounts charged are administrative costs that were indeed incurred. Informal, nonbinding remarks of Kevin Knopf (Treasury Department Office of Benefits Counsel) at July 11, 2002 ECFC Conference.

**19** Informal, nonbinding remarks of Kevin Knopf (Treasury Department Office of Benefits Counsel) at July 11, 2002 ECFC Conference.

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