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Center for Health

Working Retirees Can Cause Compliance Issues with HRAs

Introduction

Some CBOs and Treasurers have contacted Wespath Benefits and Investments (Wespath) recently to ask about situations where local churches or other United Methodist Church ("UMC") entities have hired individuals who had retired previously and had been given a health reimbursement arrangement ("HRA"). If this HRA is not terminated or suspended when the retiree returns to work, it may raise a potential issue under the Affordable Care Act ("ACA")—at least as it presently stands— and may also cause problems under the Medicare Secondary Payer ("MSP") statute.

Background

For many years before Congress passed the ACA in 2010, the Internal Revenue Code allowed employer reimbursements of employee expenses for medical care to be excludable from the employee's income, if the reimbursements were provided through a health plan[1]. One popular method of providing such reimbursements was through an HRA.

The ACA created a new rule[2] that a group health plan may not have an annual limit on the dollar value of plan benefits. Moreover, the IRS issued guidance[3] stating that any account-based plan, including an HRA, will be considered a health plan if it reimburses employee expenses for medical care. Since HRAs generally reimburse medical expenses up to a specified dollar limit, they violate the ACA rule prohibiting group health plans from having an annual dollar limit, unless an exception to the rule is identified.

Annual conferences ("Conferences") that fund HRAs that are *only available to retirees*[4] can take advantage of the IRS position that, if a plan has no current employees participating in it, it is exempt from the ACA rules governing group health plans[5]. However, if employees retire and receive an HRA, then return to work, the IRS may deem the HRA a group health plan provided by the individual's current employer and seek to impose penalties. The penalty is $100 per day for each day of noncompliance for each individual impacted[6]. Thus, this issue may cost an employer as much as $36,500 per year per individual.

This white paper discusses some of the ways in which this issue may arise and attempts to identify risks and options for consideration.

1 See Internal Revenue Code Sections 105 and 106; Revenue Ruling 61-136.

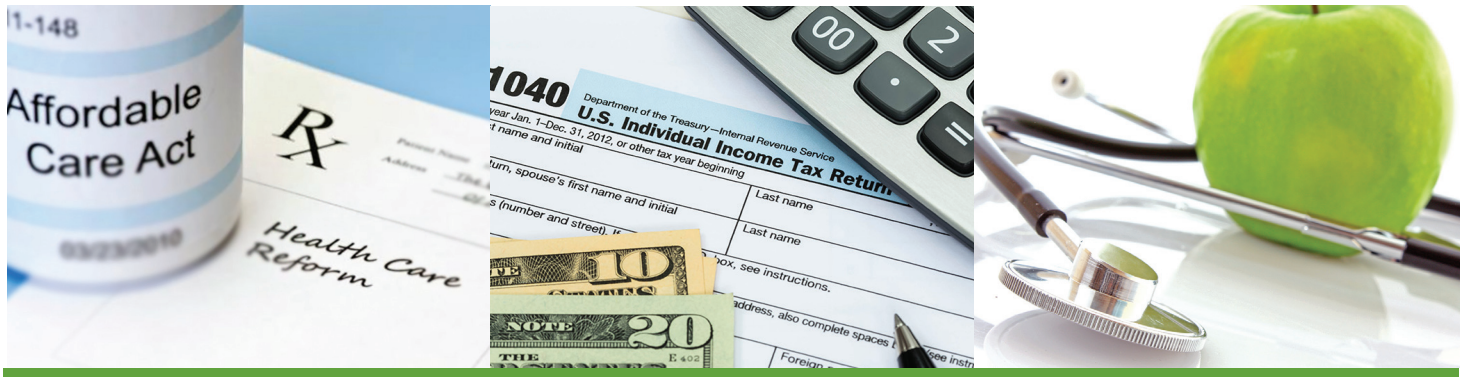
2 ACA Section 2711.

3 The IRS published final regulations on this rule on November 18, 2015. See 80 Federal Register 79190 ff.

4 HealthFlex has taken the same position for the HRAs that are provided in connection with its OneExchange program.

5 Technically, the provision the IRS relies upon creates an exception for "any group health plan for any plan year if, on the first day of such plan year, such plan has less than 2 participants who are current employees." Code Section 9831. Thus, a retiree-only plan would qualify for the exception, and so would a plan that had only one employee participating in it.

6 26 USC 4980D (b).



Defining the Employer in the UMC

The UMC faces a different situation than most employers. *The Book of Discipline* indicates that clergy are not employees of a local church or the annual conference (¶143), but acknowledges that for certain limited purposes governments may classify clergy as employees, such as for taxation and benefits. The *Discipline* notes that if such classifications are accepted, it will be only for the limited purpose indicated.

After the passage of the ACA, Wespath, together with the benefit boards of other denominations, submitted a comment letter in 2013 urging the IRS to apply the employer mandate (for applicable large employers to provide coverage to full-time employees) at the local church level in all denominations[7]. For the time being, the IRS has given churches, conventions and associations of churches permission to use a "reasonable good faith interpretation standard" for determining who is an applicable large employer, and has reserved the right to issue further guidance.

Thus Conferences and other UMC entities may make their own determinations of who the employer is for purposes of the ACA. For a discussion of some of the factors involved in the determination, see *Health Care Reform—Employer Shared Responsibility Rule/Part 5* (available at **wespath.org/assets/1/7/4570.pdf**).

In contrast to the IRS, Congress has provided guidance related to the occasions on which church entities are to be considered together as a single employer vs. when entities are to be treated as separate employers. See *Legislative Update—Clarifications to Church Plan Provisions: Retirement, Health and Welfare* (available at **wespath.org/assets/1/7/4891.pdf**).

As it relates to health benefits, the Conference must establish a conference board of pensions, which has the authority to require local churches to adopt a group health plan (¶639.7).

The board must also provide access to Medicare supplement plans for certain retired[8] clergy who are eligible for Medicare (¶639.6), but is not required to subsidize these plans. Thus, the conference board sets policy and provides administrative assistance in the provision of health benefits.

In many cases, Conferences will fund HRAs for retired clergy who are eligible for Medicare, creating or obtaining documentation of the terms of the HRA. In many, if not most cases, the IRS will look to the terms to analyze the HRA's compliance with the ACA and other regulations. Thus, the Conference will want to consider how the HRA plan or plans[9] are defined, and which retirees are covered.

Possible Compliance Scenarios

Scenario 1:

If a pastor who works for several local churches over the course of a career retires, the Conference might hire a third-party administrator ("TPA") to administer a retiree-only HRA[10], and the pastor would receive reimbursements from the HRA, with annual funding amounts determined by the Conference. The HRA would be funded from Conference accounts, which in turn are composed of apportionment payments from the churches plus investment earnings. The IRS would most likely recognize this as a retiree-only HRA and would consider it compliant with the ACA.

[7] (See Church Alliance letter, March 18, 2013, available at **http://church-alliance.org/sites/default/files/images/u2/Church_Alliance__Comment_Letter_on_Employer_Shared_Responsibility_NPRM_AQH.pdf**)

[8] Specifically those who have retired in accordance with ¶358.1, 358.2b, 358.2c, or 358.2d other than as applied to 358.2a. See ¶639.6)

[9] Some general principles regarding the identity and number of plans an employer has for HIPAA portability purposes were articulated in regulations proposed in 2004, which may still be relevant. These regulations suggested that deference might be given to the plan documents in terms of which employees or former employees were covered by which plans, so long as the plans were also operated as separate plans, and so long as evading a legal requirement was not the purpose of separating the plans. Prop. Treas. Reg. 54.9831-1(a)(2).

[10] Whether the arrangement is considered a single plan, or a number of plans administered by the same TPA, may depend on how the instruments governing the plan are drafted.

Scenario 2:
If a retired pastor who is receiving HRA reimbursements returns to work for a church where he or she previously worked, the IRS might ask if the HRA is being provided by that church. In response, the church could indicate that the HRA is a benefit earned over a lifetime of service, not a benefit of the current employment, regardless of the pastor's prior service at that location. The IRS could view the HRA as a benefit of current employment or may simply ask if the current employer is a sponsor of the HRA. Even if multiple employers/churches are paying money into/sponsoring the HRA, the IRS may view the current employer as the provider.

Scenario 3:
If a clergyperson entered the retired relationship under one of the *Book of Discipline* provisions after working for the Conference office for his or her entire career, and then kept working full-time for the Conference office while receiving an HRA, the risk of the IRS viewing the HRA as being provided by the clergy's employer would seem more obvious.

Thus, we might consider different levels of risk in this regard. Generally, we might assume for the moment that the Conference and the local churches would consider the employer of a person working at a local church to be the church, not the Conference. (Publication on the question of who the employer is in the UMC context: **wespath.org/assets/1/7/4570.pdf**.)

Here are some of the possibilities:

1. ***The retired pastor is hired by an employer with no relationship to the UMC*** (e.g., a department store or golf course)—no risk of a violation since the current employer is not the entity providing the HRA.
2. ***The retired pastor is appointed or assigned[11] to a UMC church in a different Conference from which he or she retired***—low risk of a violation since the HRA is being provided by the pastor's former Conference; therefore, there's little connection between the current employer and the entity providing the HRA.
3. ***The retired pastor is hired (not appointed/assigned by the bishop[11]/DS) by a different UMC local church than he or she worked prior to retirement***—low risk since the current church is arguably acting as an employer independent of the Conference.
4. ***The retired pastor is hired (not appointed by the bishop[11] or DS) by the same UMC local church that employed him or her prior to retirement, but the HRA is being funded by the Conference[12]***—some risk because the IRS might argue that the current employer is the entity that sponsors the HRA, and that the Conference is just an administrator of the HRA, or that it administers a multiple employer HRA, and that the local church is the plan sponsor of the HRA and the employer of the pastor.
5. ***The retired pastor is assigned by the DS to work at a local church, and the HRA is provided by the Conference***—higher risk since the local church might appear less obviously to be the employer. If the Conference were deemed the employer, it might be easier for the IRS to argue that the HRA is being provided by the current employer.
6. ***The retired pastor is appointed by the bishop to work at the same local church where he or she worked before retirement, and the HRA is provided by the Conference***—higher risk, due to the fact that the bishop, aligned with the Conference, is making the hiring decision.
7. ***The retired pastor is appointed by the bishop to work at the Conference office where he or she worked before retirement, and the HRA is provided by the Conference***—higher risk, because the Conference was the previous employer, is the employer now, and is providing the HRA.

Situation	Level of Risk
Retired UMC Clergyperson working for non-UMC entity (e.g., department store, golf course)	No risk
Retiree appointed/assigned to UMC church in a different Conference than the one from which he/she retired	Very little risk
Retiree hired by a local church without action by bishop or DS (church never served prior to retirement)	Low risk
Retiree hired by a local church without action by bishop or DS (church served prior to retirement)	Some risk
Retired UMC clergyperson assigned by DS to work at local church	Higher risk
Retiree appointed by bishop to same UMC church as he/she worked prior to retirement	Higher risk
Retiree appointed by bishop to Conference office where he/she worked prior to retirement (e.g., as a DS or Conference officer)	Higher risk

[11] "Appointed" would generally suggest action by the bishop; "assigned" would suggest action by the district superintendent ("DS")

[12] While the bishop or DS would normally be involved if the pastor were engaged in pastoral duties, a church might hire a person for non-pastoral duties, or perhaps for sporadic pulpit supply.

Options to Avoid Compliance Issues

Following is a discussion of some of the options that might be considered to mitigate ACA compliance concerns.

1. **Terminate the retired pastor's HRA**—This option might be combined with an increase in taxable compensation[13]. If the issue is identified before the retired pastor returns to work, he or she might be given time to spend down the HRA before returning to work.

2. **Suspend the retired pastor's HRA**—An IRS official[14] has indicated that he would treat an HRA to which access is suspended while participants are working, as a "retiree-only" HRA. His comments indicate that employer contributions could be made to the HRA while the retiree is working, but no reimbursements could be allowed until after he or she stops working for the employer. There may be administrative complexities to suspension of an HRA account, depending on the capabilities of the HRA provider/administrator. Like the first option, this option could be combined with a taxable grant or a salary increase[13].

3. **Terminate the retired pastor**—While this may be considered drastic, one employer chose this option (a non-UMC employer[15]) rather than risking the loss of the retiree-only exemption. However, this option could have other substantial legal risks.

4. **Identify and document adherence to an exception to the ACA rule.** (Possible exceptions are detailed below.)

   - *HRA "Integrated" With Other Group Health Plan*—In the preamble to the November 18, 2015 final regulations, the IRS stated that, in general, HRAs are subject to the annual dollar limit prohibition and will fail to comply because they impose an annual limit on the amount of expense the arrangement will reimburse.[16]

     In interpreting the prohibition, the IRS has taken the position that if an HRA is "integrated" with other group health plan coverage, and the other coverage complies with the prohibition (e.g., the other plan is a major medical plan that does not have an annual limit), then the two plans will be considered together, and the combined plan will satisfy the ACA.

     For employees eligible for Medicare, the IRS issued guidance[17] provides that, so long as the employer offers such employees a major medical plan that provides minimum value, the employer may also offer them an HRA that reimburses Medicare Part B or D premiums.

     For the UMC situations above, this would require offering the working retired individual in a major medical plan (such as the active plan). Providing the major medical (active) plan[18] as well as the HRA may be cost-prohibitive and not desirable.

   - *Plan of an Employer with Less Than 20 Employees (MSP-SEE)*—A more useful exception beginning in 2017 may be the one for employers eligible for the Medicare Secondary Payer Small Employer Exception ("MSP-SEE"). In the preamble to the final regulations, the IRS documented numerous complaints about the "integration" option (described above) for employees eligible for Medicare[19].

     Small employers indicated that it was impossible for them to offer a major medical plan to employees eligible for Medicare. Because small[20] employers are not required by the MSP rules to offer any health benefits to employees age 65 and older who are eligible for Medicare, these employers pointed out that some insurance companies would not even offer them a policy that would cover such employees. The IRS responded with a special rule for employers who have fewer than 20 employees and are not required to offer their group health plan to employees eligible for Medicare. Such small employers may provide HRAs to pay premiums for Medicare Part B and/or Part D, and these HRAs will be considered "integrated" with Medicare coverage, so that the combination will satisfy the ACA as of January 2017.

[13] See "MSP Options/Considerations" if applicable.

[14] In informal remarks, an IRS representative said that "suspended" HRAs (i.e., HRAs that accumulate contributions during employment but do not allow any reimbursements until after a participant has retired) should be considered retiree-only HRAs even though active employees technically have accrued account balances. (Remarks of Kevin Knopf at March 4, 2011 ECFC Annual Conference, as reported in Consumer-Driven Health Care, Section XXV.G.3.b. [EBIA 2016])

[15] See Carson v. Lake County, Indiana (N.D. Ind. 2016).

[16] 80 Fed.Reg. at 72201.

[17] Notice 2015-17, Q & A 3.

[18] Note that rehired individuals who are working full-time or who would otherwise be eligible for the plan should be offered the active plan if that is required by the Medicare Secondary Payer statute (see discussion below) or the anti-discrimination provisions of Code 105(h).

[19] 80 Fed.Reg. at 72202.

[20] "Small" in this context means employers with less than 20 employees, who do not provide coverage through a multi-employer plan that includes any employers with 20 or more employees.

There are other requirements, but this special rule[21] shows promise as a reliable exception. Unlike the integration exception previously discussed, this one does not require employers to offer major medical coverage to the Medicare-eligible individuals (but it does require that a major medical plan be offered to other employees[22]). Employers, however, may need to obtain approval for the small employer exception to the MSP statute if they provide coverage for active employees through a multiple employer plan. UMC entities intending to use this exception should ensure that they are in compliance with any approval process required by CMS.

- *Plan Providing Limited Scope Benefits (or other Excepted Benefits)*—The IRS confirmed in the final regulations that the market reforms, including the annual limit prohibition, do not apply to a group health plan in relation to its provision of excepted benefits described in Code section 9832(c).[23] If the HRA was limited to reimbursement of dental or vision benefits, for example, it would not be subject to the annual limit prohibition. Based on feedback from UMC entities, it seems that restricting the HRA benefits in the manner required for this exception may not be viewed favorably by retired pastors.

- *Plan with Less Than Two Participants Who Are Current Employees*—A church may be exempt from penalty if only one employee is involved. The final IRS regulations clarified the IRS' position that an HRA with fewer than two participants who are "current employees" is exempt from the ACA's "group health plan" market reform requirements[24]. Thus, if a church had only one employee in its HRA, the ACA requirements and penalties would not apply[25]. *(**Note:** The IRS stated in Notice 2015-17 that an employer with more than one current employee cannot maintain separate plans[26] for each employee; the IRS would treat the two as one group plan—subject to the ACA market reforms.)*

  The one-employee exception also requires employers to follow the nondiscrimination rules under Section 105(h) of the Code, which might prohibit offering an HRA to only the clergy and not offering it to other similarly situated employees, particularly lower-paid employees.

  For purposes of the UMC HRA plans, if the HRA was sponsored and administered by the local church with only one working retired employee in the HRA, this exception may work. If the HRA is administered by the Conference and not the local church, there would be risk that the IRS could characterize the HRA plan as including more than one current employee even if no more than one employee worked at any one church.

MSP Options/Considerations

One additional question may be applicable to a subset of employers: *Does the employer sponsor a group health plan for its active employees that Medicare will expect to cover and be the primary payer for the working retiree[27]?* If so, a number of restrictions will apply, including a prohibition on any financial or other incentive for the person to waive the active group health plan and a prohibition on providing any individual coverage complementary to Medicare. Thus, individuals who are required to be eligible for such an active group health plan due to their working status can voluntarily choose to waive coverage in that plan, which will make Medicare primary. However, any provision of an HRA by the employer (church/Conference) would likely be viewed as an impermissible plan offered as an incentive to waive coverage/complement to Medicare.

[21] The regulation appears at 80 Fed.Reg. 72244.)
[22] See 54.9815-2711(d)(5)(i), at 80 Fed.Reg. 72244.
[23] 80 Fed.Reg. at 72201, note 45.
[24] 80 Fed.Reg. at 72201, note 45. ("… the market reforms … do not apply to a group health plan that has fewer than two participants who are current employees …")
[25] Note: It is possible that a court in a future ruling might disagree with the IRS' position on this exception.
[26] Notice 2015-17 dealt with employer payment plans, but the regulations of November 2015 indicate that the same annual limit rule applies to all account based plans.
[27] Generally, Medicare will expect the group health plan of an employer with 20 or more employees to pay primary with respect to an employee who is 65 or older and who would be covered if he/she were younger than 65. It will also expect smaller employers to pay primary in such a situation, if they provide coverage through a multiple employer plan that includes another employer with 20 or more employees. An employer with less than 20 employees that participates in such a multiple employer plan can take advantage of an exception to this rule if the plan requests an exception and identifies the individuals for whom it seeks treatment under the exception. 42 CFR 411.172.

If employers decide to terminate or suspend the HRA to avoid ACA penalties, they should be cautious about providing grants or other increases to income if the working retiree wants to waive an employer's active plan which would (absent the waiver) be primary to Medicare, lest the additional income be deemed an incentive to waive the group health plan (GHP).

If employers are considering one of the exceptions to the ACA rule, they should consider whether the HRA they are providing to any working retiree who waives a GHP which would otherwise be primary to Medicarewill be deemed "coverage complementary to Medicare[28]," or a prohibited incentive to waive the GHP. In most cases, however, it appears that a retiree who goes back to work does so part-time. If the employer generally does not cover younger employees working on a similar part-time basis, it appears permissible for the employer to exclude the re-hired retiree from the GHP[29]. Thus, Medicare would not expect the GHP to be the primary payor, and the restrictions on providing incentives or plans supplemental to Medicare will not apply.

Proper Planning is Essential to Avoid Risk of Penalties

While no one choice may be ideal for all affected employers, the options set out above may provide some basis for discussion. In particular, it appears that the following two options may be reasonable solutions for most employers of retired clergy who are provided an HRA and then come back to work:

1. Suspension or termination of the HRA while the person is working (combined with an increase in taxable compensation, if permitted under the MSP rules described above);
2. Continuation of the HRA pursuant to the new special rule for employers that are eligible for the small employer exception to the Medicare Secondary Payer statute.

While in economic substance, the HRAs administered by Conferences may indeed be a reward for a lifetime of service to the church, and not provided as a term of current employment for a rehired individual, it is not clear that the IRS would view the situation this way. Thus, Conferences should examine the available options and see which approach provides the best protection from exposure to ACA penalties.

Center for Health's Mission

The Center for Health(CFH) seeks to improve multiple dimensions of health and well-being—physical, emotional, spiritual, social and financial—of clergy and lay workers of The United Methodist Church and their families. Center for Health offerings include strategic consultation and collaboration for plan sponsors, comprehensive programs, information and educational resources focusing on wholistic health and wellness, long-term clergy health monitoring and assessments, and network coordination with other UMC agencies, seminaries and conferences.

CFH offerings include a comprehensive health plan, strategic consultation, health plan programs a wealth of well-being resources and information, health risk assessment, health coaching and an interactive walking program.

To learn more about the Center for Health visit **wespath.org/center-for-health/**.

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[28] 42 CFR 411.172(c). An employer should not provide a plan that pays, for example, for co-insurance on services covered by Medicare. (It appears permissible to pay for items that are not covered by Medicare, such as eyeglasses. See "Group Health Plans: Federal Mandates Other Than COBRA and HIPAA" [EBIA 2016], Section XXV.G.)

[29] Even for employers subject to the MSP statute, it does not require them to treat the Medicare-eligible person better than other employees; it only requires that Medicare not be taken into account and that they be offered "the same benefits under the same conditions" as are offered to employees younger than 65. 42 U.S.C. §1395y(b)(1)(A)(i)(II). See 42 CFR 411.108(b)(1) (permissible distinctions).

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