COMPLIANCE OVERVIEW

ICHRAs: Pros and Cons for Employers

An individual coverage health reimbursement arrangement (ICHRA) is a type of employer-funded health care account that provides an alternative to traditional group health plan coverage. Employers of all sizes may use ICHRAs to reimburse employees' premiums for individual health insurance policies on a tax-free basis. Depending on their design, ICHRAs can reimburse other out-of-pocket medical care expenses, including employees' premiums for Medicare coverage.

ICHRAs have several advantages over traditional group health plan coverage. Most significantly, ICHRAs allow employers to control costs and limit their financial risk by setting a reimbursement limit each year. With an ICHRA, there are no unexpected high-cost claims to pay or substantial rate increases to worry about. However, ICHRAs are not the right fit for every employer. For example, an ICHRA may not be suitable for an employer that has employees who qualify for Affordable Care Act (ACA) premium tax credits for coverage purchased through an Exchange (or Marketplace).

Before deciding whether to offer an ICHRA, employers should understand the benefits and drawbacks of this type of health care account. This Compliance Overview highlights ICHRAs' pros and cons for employers to consider.

LINKS AND RESOURCES

- Final rules on ICHRAs, released by the U.S. Departments of Labor, Health and Human Services, and the Treasury (Departments)
- FAQs on the final rules, which include the model substantiation form and the model annual notice

Key Advantages

- Employers can more effectively control their health care spending.
- Employers can decide which classes of employees will be eligible and how much will be contributed for each employee class.
- The value of coverage is not taxable and reimbursements are tax-free to employees.

Key Disadvantages

- Employers need to invest time and resources to learn how ICHRAs work, educate employees and address their concerns.
- ICHRAs have their own set of administrative and compliance requirements.
- ICHRA coverage prevents employees from receiving ACA premium tax credits.

ICHRA Pros

Employers may consider implementing an ICHRA because it offers the following advantages:

- **Cost control**—With an ICHRA, employers define how much they contribute each year, giving them more control over their health care spending by eliminating risk and avoiding renewal rate surprises. Employers can increase their contribution levels from year to year to keep pace with inflation, but there are no minimum or maximum contribution amounts for an ICHRA.

- **Flexibility**—Employers can decide which classes of employees are eligible for the ICHRA and how much is contributed for each employee class. Employers may also continue to offer a traditional group health plan if the ICHRA and the traditional group health plan are offered to different classes of employees. However, employers must comply with the following restrictions:
  - Employers cannot offer any employee a choice between an ICHRA and a traditional group health plan. Employers with both types of benefits must offer them to different classes of employees;
  - In general, an employer must offer the ICHRA on the same terms to all employees within a class of employees. Employers cannot vary their ICHRA contributions based on a percentage (for example, 80%) of employees' individual health insurance premiums. Also, employers cannot offer a more generous ICHRA benefit based on an employee's adverse health factor, such as diabetes, chronic illnesses or cancer;
  - Employee classes are limited to full-time employees, part-time employees, salaried employees, nonsalaried employees, employees who work in the same rating area, seasonal employees, collectively bargained employees, temporary employees of staffing firms, nonresident aliens without U.S.-based income, employees who have not satisfied a waiting period for health coverage, and any combination of these classes; and
  - Employers may offer an ICHRA to new employees (e.g., employees hired on or after July 1, 2024) while grandfathering existing employees in a traditional group health plan to help employers transition from offering a traditional group health plan to an ICHRA. However, the ICHRA must be offered on the same terms to all participants in the new-hire subclass.

- **Tax advantages**—An ICHRA is a tax-advantaged vehicle, which means that employers may take a federal income tax deduction for contributions, the value of the coverage is not taxable to covered employees, and reimbursements for medical care expenses, including health insurance premiums, are excludable from employees' taxable income. Also, if the ICHRA does not cover employees' full premiums for individual insurance coverage, employers may permit employees to pay the balance of the premiums on a pre-tax basis through their Section 125 cafeteria plans. Although federal law prohibits employers from allowing employees to pay for Exchange coverage on a pre-tax basis, this prohibition does not apply to coverage purchased outside of an Exchange.

- **Compliance with the ACA's pay-or-play rules**—The ACA employer shared responsibility rules, also known as the "pay-or-play" rules, require applicable large employers (ALEs) to offer health coverage that is affordable and provides minimum value to their full-time employees or risk paying a penalty. ALEs may use ICHRAs to provide health coverage to their full-time employees without risking a pay-or-play penalty if the ICHRA is considered affordable. This means that to avoid a penalty, ALEs with ICHRAs will need to contribute enough for the ICHRA to be considered affordable to their full-time employees.

- **Advantages for employees**—Offering an ICHRA to part-time or seasonal employees who are not typically eligible for benefits may give employers an advantage when it comes to attracting and retaining valuable talent. It may also be a good fit for providing benefits to remote workers who are outside of the employer's area. In addition, ICHRAs give employees more control over their health coverage decisions, allowing them to select a health insurance policy that meets their personal and family needs. Employees can keep this health insurance coverage even if they switch jobs.

ICHRA Cons

When considering whether an ICHRA is the right fit for them, employers should consider the following disadvantages:

- **Unfamiliarity**—Because ICHRAs are a relatively new strategy for providing health benefits, most employers need to invest time and resources to understand how they work. Employers also need to decide whether to handle the ICHRA's administration internally or outsource it, establish eligibility rules and contribution amounts, and provide clear explanations of the ICHRA and how it functions to its workforce. Employees who have been eligible for traditional group health plan coverage may have concerns about the ICHRA's coverage and questions about finding individual health insurance coverage, which employers should be prepared to address.
- **Administrative burden**—Administering an ICHRA can be challenging. Many employers hire a third-party administrator (TPA) to manage the benefit's day-to-day administration, which adds to the employer's overall cost. In addition to tracking reimbursements and managing employee balances, an ICHRA requires employers (or TPAs) to:
    - Substantiate that eligible employees and dependents are enrolled in individual health insurance (or Medicare) coverage. This substantiation must be provided in advance of each plan year and prior to each expense reimbursement;
    - Allow eligible employees to opt out of ICHRA coverage in advance of each plan year; and
    - Provide an annual notice to eligible participants regarding the ICHRA and its interaction with the ACA's premium tax credit.
- **Compliance requirements**—ICHRAs are subject to their own strict legal rules, including substantiation and notice requirements. In addition, an ICHRA is a group health plan that is subject to ERISA. This means that employers with ICHRAs must comply with ERISA's reporting and disclosure rules (for example, the summary plan description and Form 5500 requirements) and its fiduciary responsibilities. ICHRAs are also subject to COBRA's continuation coverage requirements unless an exception applies. In addition, to avoid pay-or-play penalties, ALEs must ensure that the ICHRA's coverage for full-time employees satisfies the ACA's affordability threshold for each plan year.
- **Impact on premium tax credit**—ICHRAs can prevent eligible employees from receiving ACA premium tax credits, which reduce premiums for health insurance purchased through an Exchange. An individual who is eligible for an ICHRA is not eligible for a premium tax credit for any month when the individual is enrolled in the ICHRA or the individual opts out of the ICHRA, but the ICHRA is considered affordable under the ACA's rules.
- **Disadvantages for employees**—Employees may be skeptical of ICHRAs because they require employees to purchase individual health insurance policies (or have Medicare coverage). Eligible employees cannot have other group health coverage (for example, they cannot be enrolled in health coverage through a spouse's employer). The availability of individual coverage options may be limited depending on the strength of the insurance market

where an employee resides. With individual health insurance policies, employees bear the risk of rising insurance premiums from year to year, which may contribute to employee uncertainty with this benefits approach. Also, employees may select policies that have lower monthly premiums but higher cost sharing, potentially leaving them vulnerable to high out-of-pocket expenses in the event of unexpected medical issues.