TAX in the News

Tax Information for Tax Practitioners

December 5, 2018

Upcoming IRS webinars—
Tax Reform Basics for the QBI Deduction presented by Communications and Liaison, Thursday, Dec. 6 at 2:00 PM ET; 60 minutes, 1 hour of CE
Tax Reform Due Diligence Requirements presented by Communications and Liaison, Thursday, Dec. 13 at 2:00 PM ET; 60 minutes, 1 hour of CE

TAX NEWS

HRA Expansion Proposal Would Potentially Allow More Employers to Offer HRAs—Following the ACA's passage, employers' ability to offer health reimbursement arrangements (HRAs) to their employees was limited. Briefly, an HRA is a type of group health plan in which an employer pays or reimburses medical expenses of employees who do not have employer-sponsored coverage. A new proposal put forth by the IRS and other agencies would expand the availability of HRAs by allowing employers to integrate HRAs with individual health plans. Page 2

Proposed Regulations Clarify Impact of Increased Lifetime Gift Tax Exclusion---The TCJA doubled the basic exclusion amount for gifts made and estates of decedents dying after 2017 and before 2026. Proposed regulations address concerns raised about the effect of the new law on transfers made prior to 2018 and transfers made after 2025 when the exclusion is scheduled to return to its pre-TCJA level. Page 4

QUESTION OF THE WEEK

In the past, our clients have been unable to claim the child tax credit because of their high AGI, but it looks like they may be able to do so in 2018. They have two children under age 17 and one child who is a college student. Will they be able to claim the child tax credit or the new credit for other dependents in 2018? If so, how are these credits calculated with the new phaseout formula? Page 5

HRA EXPANSION PROPOSAL WOULD POTENTIALLY ALLOW MORE EMPLOYERS TO OFFER HRAS

The IRS, Department of Labor (DOL), and Department of Health and Human Services (DHHS) have issued proposed regulations that will allow many employers to offer health reimbursement arrangements (HRAs) to their employees, even if ACA limitations prevented them from doing so in the past.

Background. An HRA is a type of plan employers can utilize to offer greater choice to employees when providing health benefits. The arrangement consists of either pre-tax payments of the employee's *individual* plan premiums or tax-free reimbursements to employees for qualified medical expenses up to a certain dollar amount. The ACA disallowed the use of "stand-alone" HRAs, that is, HRAs in which the employer pays or reimburses employees who are not enrolled in employer sponsored coverage. The reason for this disallowance lies with the required "market reforms" that prohibit the integration of group health plans, which include HRAs, into individual plans. Employers that continued to offer stand-alone HRAs were subject to a penalty of $100 per day/per employee. However, there were some regulatory and legislative changes that provided some relief for these harsh penalties.

Earlier types of relief. After the passage of the ACA, the first type of relief that was available to employers could be found in Notice 2015-17, which provided relief from the penalty through mid-2015. For more information on this limited form of relief see TAX in the News February 24, 2015.

This first type of relief was very limited in scope, so in 2016 Congress passed the "21st Century Cures Act" that allowed qualified small employers to pay or reimburse employees' medical expenses up to certain limits beginning in tax year 2017. Under this new law, a qualified small employer HRA was not treated as a group health plan for purposes of the ACA market reforms and §4980D penalty. In addition, the Act extended the relief provided by Notice 2015-17 to plan years 2015 and 2016. There were many requirements that employers had to meet that limited the number of plans available. Notably, the employer needed fewer than 50 employees and could not offer any other type of group plan to any of its employees. For more information on the qualified small employer HRAs see TAX in the News December 20, 2016.

In light of these limitations, the IRS and other agencies issued proposed regulations that provide relief potentially allowing all employers the opportunity to offer HRAs.

What changes do the new proposed regulations make? In order to expand the usage of HRAs and to give employers and employees more options for health care, the IRS, DOL, and DHHS issued proposed regulations which make three major changes to the previous guidance.

- The first allows HRAs to be integrated with individual health insurance coverage as long as certain requirements are met.
- The second sets forth conditions that allow HRAs to be recognized as limited excepted benefits.
- Finally, the third proposes rules to clarify when individuals can claim the Premium Tax Credit (PTC) even if they have been offered an integrated HRA plan.

Integration of stand-alone HRAs with individual health plans

The first step the proposed regulations take is to eliminate the prohibition against the integration of stand-alone HRAs with individual health plans. In order to integrate an HRA with an individual plan, both the employer and employee must meet certain conditions, the first being that individuals and dependents to be covered by an HRA must be enrolled in individual health insurance coverage. The individual plan must not consist solely of excepted benefits (such as dental benefits), and the employee and dependents must be covered for every month they wish to be covered by an integrated HRA. Finally, if an employee qualifies for an individual plan, but fails to enroll in said coverage, the HRA would fail to comply with this condition.

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The second condition is that employers cannot offer both an HRA integrated plan and a traditional group health plan to the *same* class of employees. Note how this differs from previous guidance that prohibited the employer from offering a traditional health plan to *any* of its employees. Generally, the term "traditional group health plan" means any group health plan *other than* an account-based group health plan (such as an HSA) or a group health plan that consists solely of excepted benefits. There are eight classes of employees, including full- and part-time employees, and seasonal employees. The definitions of these classes of employees may follow §4980H ACA rules (30 hours for full-time, e.g.) or §105 non-discrimination rules, but must be followed consistently. See the proposed regulations for detailed explanations of each employee class.

The proposed integration rules generally require that a plan sponsor that offers an HRA integrated with individual health insurance coverage to a class of employees must offer the HRA on the same terms (that is, both in the same amount and otherwise on the same terms and conditions) to all employees within the class. Existing rules regarding integration with non-HRA group coverage and with Medicare require plan sponsors that offer HRAs to allow participants to opt out of and waive future reimbursements from the HRA at least annually also apply to integrated HRAs.

The third condition requires that an HRA must implement, and comply with, reasonable procedures to verify that individuals whose medical care expenses are reimbursable by the HRA are, or will be, enrolled in individual health insurance coverage (other than coverage that consists solely of excepted benefits) during the plan year. The reasonable procedures may include a requirement that a participant substantiate enrollment in individual health insurance coverage by providing either: (1) A document from a third party showing that the participant and any dependent(s) covered by the HRA are, or will be, enrolled in individual health insurance coverage during the plan year; or (2) an attestation by the participant stating that the participant and any dependent(s) are or will be enrolled in individual health insurance coverage, the date coverage began or will begin, and the name of the provider of the coverage.

The excepted-benefit HRA

The term "excepted benefits" basically refers to certain benefits outside of or in addition to traditional health plan coverage and which don't interfere with requirements for that coverage. Typical examples include dental and vision benefits. The proposed regulations now allow employers to offer an "excepted-benefit HRA." This special type of HRA is available to employers who do not wish to comply with the integrated HRA rules or cannot qualify to use them. There are four requirements for an HRA to qualify as an excepted benefit HRA:

1. The HRA must not be an integral part of the plan,
2. The HRA must provide benefits that are limited in amount (for 2019 $1,800 adjusted for inflation beginning 2021),
3. The HRA cannot provide reimbursement for premiums for certain health insurance coverage, and
4. The HRA must be made available under the same terms to all similarly situated individuals.

This limited type of HRA may be beneficial for employers who are unable to comply with the integration rules covered in the previous section.

HRA impacts on premium tax credits

An individual who is covered by an HRA integrated with individual health insurance coverage is ineligible for the PTC. In addition, if an employee opts-out of an HRA that is affordable or that provides minimum value coverage, said employee cannot claim the PTC. This rule clarifies the old rule that eliminated PTC eligibility for those covered by HRAs. On the other hand, if the plan is unaffordable, as defined in the proposed regulations, or does not offer minimum value coverage the employee may be eligible for the PTC.

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In general, a self-only coverage HRA is unaffordable if the employee's required contribution is more than 8.16% (for 2018) of household income. In order to ensure that participants who are eligible to participate in an HRA integrated with individual health insurance coverage understand the potential effect that the offer of and enrollment in the HRA might have on their ability to claim the PTC, the proposed rules include a requirement that an HRA provide written notice to eligible participants. The HRA would be required to provide a written notice to each participant at least 90 days before the beginning of each plan year and include the ability for the employee to opt-out of reimbursements under an HRA.

Action items. Under prior forms of relief, most employers did not qualify to offer an HRA plan to their employees, and often by the slimmest of margins. These new regulations offer a method for wider applicability of HRAs, and as such employers may wish to evaluate their current benefits structure. Interested employers should contact their benefit departments or health benefit advisors to see if a change would be beneficial. Most changes are proposed to apply to plans starting January 1, 2020 after final regulations are published.

PROPOSED REGULATIONS CLARIFY IMPACT OF INCREASED LIFETIME GIFT TAX EXCLUSION

The Treasury Department and the IRS have issued proposed regulations addressing potential concerns regarding the new increased basic exclusion amount (BEA) for gifts under the TCJA. For 2017, this amount was $5.49 million, and it increased to $11.18 million in 2018 due to the TCJA changes. As under prior law, the BEA is inflation-adjusted each year. The BEA is used to figure the available credit against gift tax, which is used during an individual's lifetime to offset gift tax. Any remaining credit is applied against the value of the deceased individual's estate to reduce or eliminate potential estate tax. Based on concerns raised since the TCJA's passage, the regulations address four separate situations and how the increased BEA would apply to them.

Impact of Pre-TCJA taxable transfers on the amount of BEA available during 2018-2025

The regulations address circumstances where a donor exceeded the lower BEA in effect for a prior period, and whether the increased BEA available from 2018-2025 would be reduced both by the prior (lower) allowed BEA plus the taxable gift made that exceeded the earlier BEA in those prior years. The regulations clarify that these earlier taxable gifts would not reduce the amount of the increased BEA available to the donor. The first situation applies this rule in the context of gift taxes, while the second applies it for estate tax purposes. Since the BEA is unified for gift and estate tax purposes from 2018-2025, the result is the same in both: prior gifts on which gift taxes were paid do not reduce the available BEA.

Impact of transfers made during 2018-2025 after the BEA decreases in 2026

The third and fourth situations concern how the increased BEA affect later (post-2025) calculations for both gift and estate taxes, respectively. Commenters had expressed concern that once the BEA decreases again in 2026, prior gifts that were not taxed from 2018-2025 could wind up subject to a *de facto* tax or *clawback* in later years. Indeed, for decedents dying after 2025, the plain language of §2001(b) would potentially subject previously untaxed gift amounts in excess of the year-of-death BEA to estate tax, effectively eliminating the benefit of the increased BEA.

To alleviate this concern in the context of estates, if the date-of-death credit allowed against the BEA is less than the sum of the credits allowed against lifetime gifts, the estate may use that larger amount to figure the estate tax owed. For example, if a decedent had made taxable gifts of $9 million in 2018, all of which were sheltered from gift tax by a BEA of $11.18 million applicable in that year, and if the decedent died after 2025 when the BEA was reduced to $5 million (adjusted for inflation), the credit to be applied in computing the estate tax is that based upon the $9 million of BEA that was used to compute gift tax payable in 2018, and not the lower BEA in effect for the year the decedent died.

QUESTION OF THE WEEK

Q. Our clients' 2018 AGI should be about $460,000. In previous years they were not eligible for tax credits because of their high income. They are joint filers with three children, ages 13, 16, and 21 (the 21-year old is in college and will graduate in May 2019). Will they be able to claim the child tax credit or the new credit for other dependents in 2018? How does the phaseout formula work if they're eligible for both credits? At what point would their credit be completely phased out.

A. It appears your clients will be eligible for child tax credits (CTCs) and the credit for other dependents (ODC) in 2018.

Under the TCJA, the maximum CTC was increased from $1,000 to $2,000 per qualifying child and the new $500 ODC was added for dependents who don't qualify for the CTC. Especially relevant to your clients, the MFJ credit phaseout begins at modified AGI of $400,000 (increased from $110,000). The credit is reduced by $50 for each $1,000 (or 5% of the excess) over the phaseout threshold. The phaseout is applied to the total credit, that is, the sum of all CTCs and ODCs the client is eligible to claim.

Applying this information to your clients, they have two qualifying children under 17 and one qualifying child who is over 18 and a student. Their total credit before considering the phaseout is therefore $4,500 [($2,000 CTC × 2) + $500 ODC].

The phaseout reduction is $3,000 [($460,000 AGI - $400,000 MFJ phaseout threshold) × 5%]. The resulting potential credit is $1,500 ($4,500 total credit - $3,000 phaseout amount).

Note that next year your clients will probably not be able to claim the CTC/ODC given the same AGI. That is because their second child will turn 17 and thus will be eligible for the ODC rather than the CTC. If their oldest child is no longer a dependent after graduation, the maximum credit before phaseout will be only $2,500 ($2,000 CTC + $500 ODC) which is less than the phaseout amount. To determine the ending AGI for the credit, divide the total maximum credit by 5% and add the result to the phaseout threshold. In this example, the result would be $450,000 [($2,500 total credit ÷ 5%) + $400,000]. That would mean your clients would need AGI to be less than $450,000 next year to claim the credit.

> **Forms update**: Form 1040 and Instructions for tax year 2018 have not yet been finalized by the IRS. The most recent draft Form 1040 Instructions contain a Child Tax Credit and Credit for Other Dependents Worksheet that would be used to calculate the allowable credit. The most recent draft Form 1040 shows the combined child tax credit/credit for other dependents would be claimed on line 12a of Form 1040. Taxpayers who qualify for the additional child tax credit will continue to calculate the refundable portion of the credit on Schedule 8812.