

# PRAs: A Different Kind of Cafeteria Plan Entrée

by Rich Glass, JD

Imagine a different kind of cafeteria. Instead of serving traditional fare – this cafeteria allows customers to bring whatever food they want to the cash register. Then, in a unique twist, the customer is reimbursed for their food on a pre-tax basis, of course.

This may sound a little far-fetched for a restaurant, but it is feasible in delivering health benefits through an employer-sponsored cafeteria plan. Premium reimbursement accounts (PRAs) allow employees to choose the type of insurance coverage they want and pay for it on a pre-tax basis. Thus, a single employee in her 20s can choose a plan that is very different from that of a 30-something employee whose family is in growth mode. Another PRA option is to pay for COBRA coverage through a previous employer.

Employers are spared the headaches of sponsoring a health plan, which can include rate increases, plan documentation and reporting, and HIPAA and COBRA compliance. The IRS has officially blessed PRAs as a cafeteria plan benefit option in the Proposed Cafeteria Plan Regulations, issued in August 2007. The IRS had previously approved the concept of pre-taxing individual premiums back in 1961 in Revenue Ruling 61-146.

In the proposed regs, the IRS confirmed three different methods of reimbursement:

1. The plan reimburses the employee directly after reviewing proof of premium payment.
2. The plan issues the employee a check payable to the insurance carrier.
3. The plan issues the employee a check payable jointly to the carrier and the employee.

While not entirely clear, it appears that the cafeteria plan could only reimburse the employee's premiums, not the premiums of a spouse or dependent. The IRS did not officially endorse list billing in which the plan pays the carrier directly for premium of a variety of individual policies. But this longstanding practice is probably acceptable as an extension of the second option above. More IRS guidance is needed.

You might see an increase in these benefit vehicles in the coming years. However, employers should consider a few dark clouds before adding a PRA as a benefit option. The issues relate primarily to four laws: ERISA, COBRA, HIPAA, and Section 125 itself.

### ERISA and PRAs

Individual insurance could be construed as an employer-sponsored group health plan if there is sufficient employer endorsement. This would subject the PRAs to ERISA reporting and notice rules, among other requirements. To avoid ERISA application, a prudent employer would want the PRAs to qualify for the voluntary plan safe harbor:

- The employer makes no contributions.
- Participation is voluntary.
- The only employer functions are allowing carriers to publicize their policies and collect and remit premiums.
- The employer does not profit in any way from the PRAs.

An employer can contribute to employees' PRAs – just like it shares premium costs for employer-sponsored coverage. But if it does, ERISA will apply.

### COBRA and PRAs

If ERISA applies, COBRA will apply also unless there is an exception, such as for small employers. This presents additional problems. First, the carrier may have policy provisions that allow it to cancel coverage for reasons that are impermissible in COBRA. In such a case, the employer might be on the hook to self-insure the remaining months of COBRA. Second, the carrier may want to increase premiums at varying times, which could run afoul of the COBRA rule that premiums must be fixed throughout a 12-month determination period. Third, the employer would want to clarify who should handle reporting of secondary events and disability extensions.

### HIPAA and PRAs

If a group health plan exists, many provisions of HIPAA likely exist as well unless the plan is an excepted benefit, such as dental or vision. For example, HIPAA's portability rules require plans to provide special enrollment rights and certificates of creditable coverage. Will carriers follow the same rules? If the carrier does not do so, employees may look to the employer sponsoring the cafeteria plan.

In addition, HIPAA has a nondiscrimination rule, which prohibits group health plans from considering any health factor in determining eligibility, benefits, or costs. Al-

most by definition, individual policies take into account factors such as claims experience and medical history in determining eligibility and premiums. In other words, an unhealthy person is unlikely to get the same policy at the same cost. One way around the nondiscrimination requirement is to limit PRAs to policies that are subject to HIPAA guaranteed issue-renewability requirements.

### Section 125 and PRAs

The PRA is subject to many of the basic rules because it is a cafeteria plan option. First, cafeteria plan elections are generally irrevocable unless there is a change of status or other permissible exception. If an employee drops or loses individual coverage mid-year, the PRA deductions would normally have to continue until the end of the plan year.

Second, cafeteria plan benefits cannot defer compensation from one plan year to the next. PRA reimbursements would need to be limited to coverage for that particular plan year. This may require employees to prepay for the first month of coverage in a plan year and then seek reimbursement.

### Conclusion

PRAs can offer employers a viable alternative to sponsoring a group health plan, especially if the alternative is to offer nothing at all. Employers need to be aware of the risks. There is no specific, formal guidance yet on how or if PRAs would be subject to ERISA, COBRA, and HIPAA. The IRS and Dept. of Labor have noted that it is a gray area. Employers should not be dismayed by the uncertainties. With thorough planning, careful risk evaluation, and clear communication, employers can make PRAs a delicious entrée on their cafeteria plan menu. □

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