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Direct Primary Care Arrangements and Health Care Sharing Ministries Receive Favorable Tax Treatment Under Proposed Regulations

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On Monday, June 8, 2020, the Treasury Department ("Treasury") and the Internal Revenue Service ("IRS") released Proposed Regulations addressing the tax treatment of amounts paid for two unique types of medical arrangements – Direct Primary Care ("DPC") arrangements and Health Care Sharing Ministries ("HCSMs") – as well as for certain government health plans. The Proposed Regulations were issued in response to the June 2019 Executive Order 13877, "Improving Price and Quality Transparency in American Healthcare to Put Patients First," which directed Treasury to propose regulations to treat expenses related to certain types of arrangements, including DPC arrangements and HCSMs, as eligible medical care under Internal Revenue Code ("Code") Section 213(d).

Subject to certain conditions, the Proposed Regulations generally treat payments for both DPC arrangements and HCSMs as tax-favored "medical care" under Code Section 213(d), either as a payment for medical care or as medical insurance. The Proposed Regulations also clarify that amounts paid for health maintenance organizations ("HMOs") and certain government-sponsored health care programs are amounts paid for medical insurance under Code section 213(d).

Comments on the Proposed Regulations are due by August 10, 2020. Treasury and IRS "strongly encourage" stakeholders to submit comments electronically, due to COVID-19 related concerns with processing paper comments.

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Background

Code Section 213(a) allows individuals to take a deduction for expenses for medical care to the extent the expenses exceed a certain percentage of adjusted gross income (generally, 7.5% for 2020 and 10% for taxable years beginning on or after January 1, 2021). Expenses for "medical care" are broadly defined in Code Section 213(d) as amounts paid "for the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body." Medical care includes insurance covering medical care.

The definition of medical care under Code Section 213(d) is cross referenced in numerous other sections of the Code and in Treasury guidance. For example, employees may use funds in health flexible spending arrangements ("health FSAs"), Health Reimbursement Arrangements ("HRAs"), and Health Savings Accounts ("HSAs") to reimburse medical care as defined in Code Section 213(d) (note, however, that FSAs and HSAs may generally not reimburse health insurance premiums).

Proposed Regulations

Direct Primary Care Arrangements

A. In General

The Proposed Regulations provide that amounts paid for certain DPC arrangements are considered to be paid for medical care under Code Section 213(d). The Proposed Regulations define a DPC arrangement as a "contract between an individual and one or more primary care physicians under which the physician or physicians agree to provide medical care (as defined in section 213(d)(1)(A)) for a fixed annual or periodic fee without billing a third party." The Proposed Regulations define a primary care physician as an individual who is a physician (as defined by the Social Security Act) who has a primary specialty designation of family medicine, internal medicine, geriatric medicine, or pediatric medicine.

GROOM INSIGHT. Under the definition in the Proposed Regulations, a DPC arrangement does not include care provided by non-physicians (e.g., nurse practitioners) or non-primary-care physicians (e.g., specialists such as obstetricians and cardiologist), or non-primary care (e.g., specialty care). The Proposed Regulations ask for comments on whether to expand the definition to include contracts with non-physician practitioners such as nurse practitioners, clinical nurse specialists, or physician assistants who provide primary care and arrangements for non-primary care, such as dental care or specialty care.

B. ERISA Treatment

A footnote in the Preamble states that the Proposed Regulations do not address any issues under ERISA, including whether any particular arrangement or payment constitutes, or is part of, an employee welfare benefit plan under ERISA. The footnote states that "[r]ather, the Department of Labor advised the Treasury Department and the IRS that an employer's funding of a benefit arrangement, in most circumstances, is sufficient to treat an arrangement that provides health benefits to employees as an ERISA covered plan."

GROOM INSIGHT. This footnote indicates that a DPC arrangement funded by an employer, presumably including employee pre-tax contributions, would create a group health plan. The Proposed Regulations do not otherwise address what would happen if an employer offered or paid for a DPC arrangement, however, such as the application of the ACA market reforms. DPCs are often marketed as falling outside the scope of insurance regulation. That is not necessarily the case, as many state laws do regulate DPCs as insurance. So, while the Proposed Regulations are favorable from a federal tax perspective, there are a myriad of other compliance issues that an administrator or employer would need to address before making this arrangement available to employees.

C. DPC Arrangements and HRAs, HSAs, and Health FSAs

The Preamble notes that a DPC arrangement could potentially qualify as either medical care (*e.g.*, payments for a DPC arrangement that solely provides for an anticipated course of specified treatments of an identified condition or solely provides for an annual physical exam) or medical insurance. Which definition applies will impact whether payments made for a DPC arrangement can be reimbursed from an HRA, HSA, or Health FSA.

1. HRAs

The Preamble notes that an HRA may provide reimbursement for DPC fees. This includes reimbursements from a qualified small employer health reimbursement arrangement ("QSEHRA"), an HRA integrated with a traditional group health plan, an HRA integrated with individual health insurance coverage or Medicare ("ICHRA"), or an excepted benefit HRA. The Proposed Regulations do not change the current requirements regarding the types of coverage with which an HRA must be integrated in order to comply with the Affordable Care Act ("ACA") market reform rules.

Groom Insight: Under the rules governing ICHRAs, in order for an ICHRA to satisfy the ACA's market reforms, it must be integrated with a plan that is sold on the individual market or Medicare. Although the Proposed Regulations do not address this point directly, the Preamble implies that an HRA could not be integrated with a DPC arrangement and satisfy the ICHRA requirements.

2. HSAs
    i. Eligibility to Contribute to an HSA

Under the Proposed Regulations, an individual would generally not be eligible to contribute to an HSA if the individual is covered by a DPC arrangement.

An individual is eligible to contribute to an HSA if the individual is covered by a high deductible health plan ("HDHP") and is not covered by any other "health plan." Certain types of coverage are disregarded in determining whether an individual has coverage that would preclude him or her from contributing to an HSA, including coverage for preventive care.

The Preamble notes that DPC arrangements will generally constitute insurance under Code Section 223(d)(1)(D) because they typically provide for primary care services such as physical examinations, vaccinations, urgent care, and laboratory testing. Treasury and IRS explain that this type of arrangement would count as health insurance that is not an HDHP (because it provides coverage before the minimum annual deductible has been met) and that is not disregarded coverage or preventive care. Thus, individuals covered by a DPC arrangement would usually be precluded from contributing to an HSA.

The Preamble notes, however, that in certain limited circumstances an individual may be covered by a DPC arrangement that solely provides for an anticipated course of specified treatments of an identified condition or solely provides for disregarded coverage or preventive care. These types of DPC arrangements would not disqualify individuals from contributing to an HSA.

GROOM INSIGHT. Note, however, that if the DPC arrangement fee is paid by an employer (including, presumably employee pre-tax contributions), that payment arrangement would be a group health plan that would disqualify the individual from contributing to an HSA unless the DPC arrangement only provided disregarded coverage or preventive care.

ii. Reimbursements from an HSA

The Proposed Regulations do not specifically address whether amounts paid for DPC arrangements may be reimbursed from an HSA. While HSA funds are supposed to be used for reimbursing medical expenses, they generally may not be used to pay for health insurance premiums unless an account owner is age 65 or over. As discussed above, whether a particular DPC arrangement is considered health insurance will depend on the facts and circumstances, but Treasury and IRS appear to assume that most arrangements will be insurance. If a DPC arrangement is insurance, HSA funds may generally not be used to pay for DPC expenses.

GROOM INSIGHT. As discussed above, individuals participating in a DPC arrangement will generally not be eligible to contribute to an HSA, but they may have HSA funds from previous years that they wish to spend.

3. Health FSAs

Health FSA funds may not be used to pay for insurance premiums. As discussed above with respect to HSAs, if an individual participates in a DPC arrangement that is insurance, it does not appear that the Health FSA may reimburse the expenses.

GROOM INSIGHT. Neither the Preamble nor the Proposed Regulations directly address reimbursements from an HSA or health FSA. Additional guidance would be helpful.

Health Care Sharing Ministries

The Proposed Regulations provide that payments for HCSMs are considered to be amounts paid for medical insurance under Code Section 213(d)(1)(D). The Proposed Regulations adopt the ACA's definition of HCSMs, which requires that an HCSM meet the following requirements:

- Be described in Code Section 501(c)(3) and be exempt from taxation under section 501(a);
- Members share a common set of ethical or religious beliefs and share medical expenses among themselves in accordance with those beliefs and without regard to the State in which a member resides or is employed;
- Members retain membership even after they develop a medical condition;
- Has been in existence at all times since December 31, 1999, and medical expenses of its members have been shared continuously and without interruption since at least December 31, 1999; and

- Conducts an annual audit which is performed by an independent certified public accounting firm in accordance with generally accepted accounting principles and which is made available to the public upon request.

The Preamble states that an HRA may reimburse payments for membership in a HCSM. This includes an HRA integrated with a traditional group health plan, an ICHRA, a QSEHRA, or an excepted benefit HRA. The Proposed Regulations do not change existing guidance for HRAs, including regarding the application of the ACA market reforms to HRAs, and the Preamble specifically states that HCSMs may not be integrated with an ICHRA in order to satisfy the ACA's market reforms (thus, an individual must also be enrolled in either individual health insurance coverage or Medicare).

Because the Proposed Regulations provide that HCSMs are medical insurance, membership in an HCSM would preclude an individual from contributing to an HSA and membership may not be paid with funds from a health FSA or an HSA (with certain exceptions).

Government-Sponsored Health Care Programs and HMOs

The Proposed Regulations clarify that amounts paid for HMOs and certain government-sponsored health care programs, including, Medicare, Medicaid, CHIP, and TRICARE, are amounts paid for medical insurance under Code Section 213.

The rules in the Proposed Regulations would apply for taxable years beginning on or after the publication of final regulations.

In conclusion, while the Proposed Regulations provide newly favorable treatment of DPC arrangements and HCSMs under federal tax law, there are many other issues, including whether such arrangements are regarded as insurance under state law, that administrators and employers would need to look into and address prior to offering these arrangements to employees. In addition, there are open questions under the Proposed Regulations with respect to the use of an HRA, HSA, and health FSA in conjunction with DPC arrangements and HCSMs.