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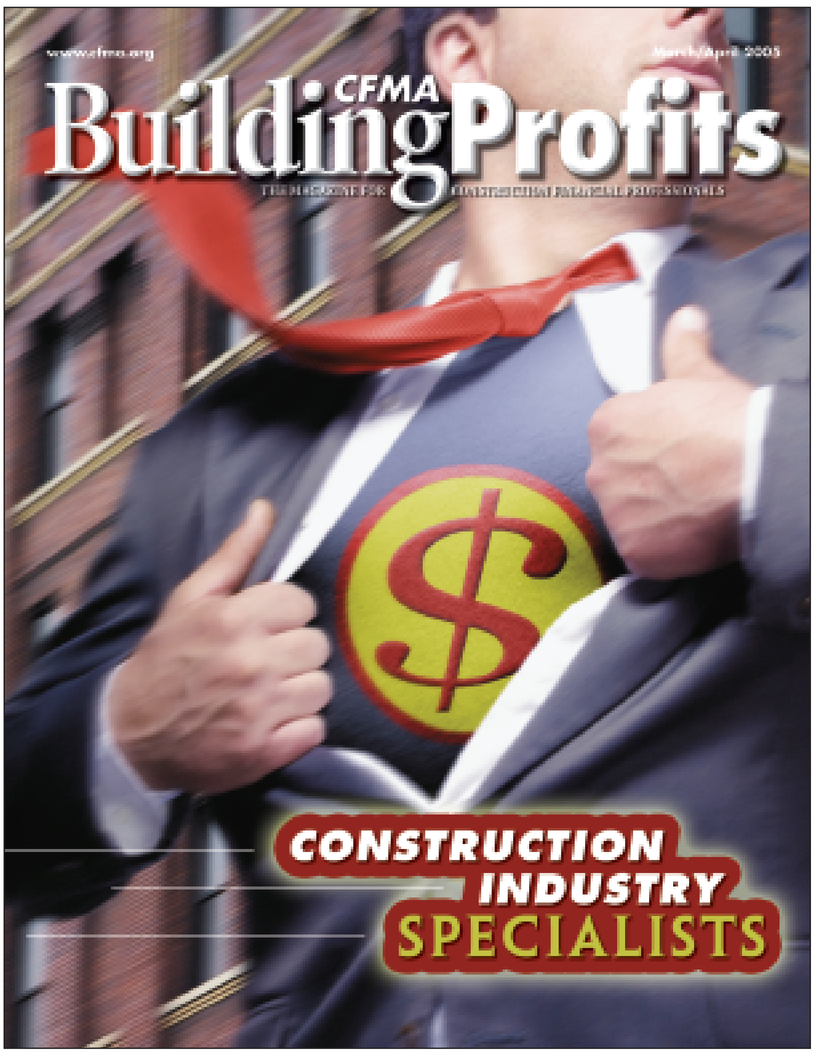

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CONSTRUCTION FINANCIAL MANAGEMENT ASSOCIATION

The Source & Resource for Construction Financial Professionals

BY JOHN J. HIGGINS

A HEALTHY BENEFITS PACKAGE:
Tools to Reduce Healthcare Costs

An attractive benefits program is one of the best ways to recruit and retain top talent in any field – regardless of the industry, or size and scope of the business. So now, more than ever, both employers and employees are looking for maximum healthcare coverage that provides the highest value.

At the same time, the cost of quality healthcare continues to increase, making it much more difficult to deliver the best possible benefits without sacrificing the health and well-being of your company's bottom line. Fortunately, several healthcare-related products are available that provide tax advantages for both employers and employees.

The most popular and effective healthcare products are the Flexible Spending Account, the Health Savings Account, and the Health Reimbursement Account. Each has its own rules, risks, and rewards, all of which contractors and CFMs should carefully evaluate to determine the best fit for their company.

Flexible Spending Accounts

The first of its kind, the Flexible Spending Account is a tax-advantaged savings account established through an employer to allow tax-free savings for qualified medical or dependent care expenses.

Using pre-tax contributions withdrawn directly from each paycheck, employees pay out-of-pocket medical insurance costs and expenses not covered under general group insurance programs; claim forms and documentation are then submitted for reimbursement.

There are two different types of Flexible Spending Accounts: Medical Spending Accounts and Dependent Care Reimbursement Accounts. (*Note:* Another product, Medical Savings Accounts, is no longer available to new enrollees as of January 1, 2004.)

Medical Spending Accounts

These accounts allow employees to use an unlimited amount of pre-tax contributions for a wide variety of qualified expenses, including: deductibles, coinsurance and office visit co-pays, prescriptions and over-the-counter drugs, dental and orthodontia services, durable medical equipment, infertility treatments, psychiatric services, and eyeglasses, contact lenses, and LASIK eye surgery.

Dependent Care Reimbursement Accounts

Dependent Care Reimbursement Accounts enable employees to set aside up to $5,000 in pre-tax dollars to cover the cost of nursery and pre-school tuition, summer day camp, and in-home care by a licensed provider, as well as qualified after-school programs.

These funds can be used for children 12 or under, or for any spouse, parent, or child of any age who cannot care for him- or herself and who qualifies as a dependent for IRS purposes.

The Rules & Rewards of Flexible Spending Accounts

To ensure that benefits are not skewed toward highly compensated employees, Flexible Spending Accounts are subject to the non-discrimination rules based on IRC §125 and §105(h). All employees who satisfy the eligibility requirements may participate.

For employers, a Flexible Spending Account is relatively easy to manage. No separate account is required for administration; rather, it is typically handled as a bookkeeping account with reimbursements paid from the employer's general assets.

As such, there are no specific reporting requirements related to contributions. Employers also see tax benefits with Flexible Spending Accounts – resulting in savings up to 10% in F.I.C.A., F.U.T.A., and possibly workers' comp premiums, depending on the company's state of operation.

The Risks of Flexible Spending Accounts

As attractive as these tax benefits are, Flexible Spending Accounts still carry a significant level of risk for employers. For example, if an employee plans to contribute $1,200 to a Medical Spending Account during the course of the election year, those funds must be available to the employee on the first day of the coverage period. Because employees can spend the entire planned contribution at any time during the election year, there is a risk that terminated or resigning employees will spend more than they contribute.

Although Flexible Spending Accounts do not require contribution limits, employers may set limits to protect their bottom line – especially when benefits are offered through a cafeteria plan. Even so, contractors who experience high turnover and rely heavily on a seasonal workforce should investigate other alternatives.

With Flexible Spending Accounts, employees choose the amount of their pre-tax dollars that will be set aside each year and risk forfeiting unused contributions. This "use-it-or-lose-it" structure has made Flexible Spending Accounts less popular in recent years. This underlying risk led to the development of other alternatives, including Health Savings Accounts.

Health Savings Accounts

Signed by President Bush on December 8, 2003, the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 created the Health Savings Account, a tax-exempt trust or custodial account established exclusively to pay the account beneficiary's qualified medical expenses.

FSAs, HSAs & HRAs at a Glance

	FSA	HSA	HRA
IRC Section	§125, §105(h)	§105(h)	§105(h)
Pre-Tax Contributions	Yes	Yes	Typically
Employer Funded	Yes	Yes	Yes
Employee Funded	Yes	Yes	No
Portable	No	Yes	Depends on plan design
Funds Available at Retirement	No	Yes	Depends on plan design
All Funds Available on Day 1 of Coverage	Yes	No	Depends on plan design
Contribution Limits	Depends on plan design	Lessor of annual deductible, or $2,650 per individual and $5,250 per family	None

The Rules of Health Savings Accounts

Designed to help individuals save for future qualified medical and retiree health expenses on a tax-free basis, Health Savings Accounts allow employees, employers, or a combination of both to make tax-advantaged contributions. Specifically:

- They can be funded on a tax-favored basis by employer and employee.
- They can be used to pay for most medical expenses on a tax-free basis.
- They are not limited to small employers and self-employed individuals.

The Health Savings Account maximum contribution is one-twelfth of the lesser of the annual deductible, calculated monthly, or $2,650 for an individual and $5,250 for a family. Employers who choose to make contributions to Health Savings Accounts must make comparable contributions for all eligible participating employees. In this event, employer contributions must be reported on an employee's W-2 form.

Health Savings Accounts can only be used in conjunction with a High Deductible Health Plan. Unlike other plans, individual employees can open a Health Savings Account only if their group coverage meets the definition of a High Deductible Health Plan.

High Deductible Health Plan Requirements

To participate in a Health Savings Account, individuals must be covered by a qualifying High Deductible Health Plan that:

- Requires an annual deductible of a $1,000 or more for individual coverage, or a minimum of $2,000 for family coverage.
- Includes an out-of-pocket limit (premiums are excluded) of $5,100 for individuals or $10,200 for families.
- Excludes office visit co-pays or prescription drug co-pays.
- Typically does not include any other health coverage.

A health plan can still qualify as a High Deductible Health Plan if dental/vision is offered or if the plan has a lower deductible (or no deductible) for preventive care, defined by the IRS as: periodic health evaluations, routine prenatal and well-child care, child and adult immunizations, tobacco cessation, certain obesity weight-loss programs, and some screening services.

State-mandated coverage of certain preventive care is not typically recognized under a Health Savings Account, unless it meets the IRS standards and excludes any treatment of an existing illness, injury, or condition.

Additional coverage can be provided through a Flexible Spending Account or Health Reimbursement Account, but only if coverage is limited and does not provide benefits that would normally be subject to the minimum deductible of the High Deductible Health Plan. For example, the Flexible Spending Account may supplement a Health Savings Account if coverage is limited to dental, vision, or preventive care not covered under the Health Savings Account.

The Rewards of Health Savings Accounts

Unlike Flexible Spending Account contributions, all Health Savings Account contributions belong to the employee; all unspent money remains in the account for use at any time. In fact, a Health Savings Account is similar to an IRA – unused dollars accrue interest on a tax-free basis, making it a viable retirement planning option that enables individuals to save for future qualified medical and health expenses.

With this account, participants can also pay for health insurance under the Consolidated Omnibus Budget Reconciliation Act (COBRA) or qualified long-term insurance. Plus, the Health Savings Account can be left to a surviving spouse to cover qualified medical expenses. When there is no surviving spouse, remaining funds become part of the estate and are considered taxable income to the heirs.

The Risks of Health Savings Accounts

Health Savings Accounts do have a few downsides. Prescription drugs cannot be addressed separately with co-pays or drug cards. Instead, prescriptions must be covered as a part of the individual's high deductible insurance plan, or under a separate high deductible plan specific to drug related expenses – meaning that prescriptions must be paid in full until the deductible is met.

In addition to the high cost of prescriptions, it's difficult to find a health plan that doesn't have a built-in drug card, so few health plans qualify for a Health Savings Account. (Through 2005, there is transition relief for health plans that pay for prescription drugs before the deductible is satisfied.)

Of course, the impact depends on the number and type of prescriptions. For instance, Health Savings Accounts may prove beneficial to families with several costly prescriptions because those families will meet their deductible quickly – saving money compared to prescription co-pays. However, this is probably not the case for most individuals or families, for whom a healthcare plan without a drug card may be less attractive or entirely unrealistic.

Individuals are solely responsible for using Health Savings Account funds for approved medical expenses. Unlike other plans, no intermediary tells employees which costs qualify prior to treatment. Any funds that pay non-qualifying expenses must be reported as income, and individuals under the age of 65 must pay an additional 10% in taxes on ineligible funds.

In addition, employees cannot deduct medical expenses covered by the Health Savings Account. As a result, participants must keep fairly detailed records of all Health Savings Account purchases, and understand that the IRS is likely to conduct an audit if there is a question about the validity of any given charge.

Also, many doctors and pharmacies confuse Health Savings Account plans with full-price services because patients pay directly until they meet their deductibles. Therefore, participants must emphasize their right to High Deductible Health Plan discounts.

In general, because a custodian or trust manages the plan, Health Savings Accounts often work best for employers who need to minimize administrative costs and want to maximize their employee cost sharing programs.

Health Reimbursement Accounts

A Health Reimbursement Account repays employees for qualified medical expenses. Health Reimbursement Accounts:

- Permit tax-free withdrawals for qualified medical expenses.
- Depending on plan design, may allow carryover of account funds, without limit, from year to year.
- Prohibit interest on account funds.

Funded solely by the employer, a Health Reimbursement Account covers such medically necessary expenses as copays, deductibles, office visits, prescriptions, and vision/dental care, as well as COBRA health insurance premiums. With a Health Reimbursement Account, contractors have several plan options:

- *First Dollar Bridge* – Bridges the gap between coverage and out-of-pocket expenses. It is typically paired with a High Deductible Health Plan.
- *Comprehensive* – Pays for all qualified medical expenses not covered by the existing health insurance plan.
- *Restricted* – Covers specific expenses such as dental or vision, or limits benefits to a particular type of expense, such as prescriptions or premiums.

Similar to Flexible Spending Accounts, employers often administer Health Reimbursement Accounts internally, paying reimbursements directly from their general assets. There are no contribution limits (unless set by the employer) and no specific information reporting requirements.

The Rules & Rewards of Health Reimbursement Accounts

Like Flexible Spending Accounts and Health Savings Accounts, Health Reimbursement Accounts are subject to the non-discrimination rules set forth in IRC §105(h). IRS Bulletin No. 2004-2 provides additional guidance (www.irs.gov/pub/irs-irbs/irb04-02.pdf).

Offered on a tax-favorable basis, coverage and reimbursements of medical expenses are generally excluded from an employee's gross income. In most cases, employers can deduct a portion of the plan's cost as a business expense. And, although it is not a requirement, Health Reimbursement Accounts can also be paired with a High Deductible Health Plan to lower a company's overall health insurance costs.

Certain Flexible Spending Account and Health Reimbursement Account providers have recently begun to offer participants a direct debit card for qualified expenses. Cards work just like a bank debit card – when swiped, expense eligibility and account balances are checked and approved (or denied) on the spot.

If approved, payment is pre-authorized, the amount is deducted from the Flexible Spending Account or Health Reimbursement Account, and healthcare providers are paid via ACH debit. Documentation and account history is provided online, which enables employers to review transactions and claims in real time. Direct debit cards streamline internal processes, save time, and free staff to focus on other tasks.

Overall, Health Reimbursement Accounts offer the versatility of a Flexible Spending Account combined with the portability of a Health Savings Account. Employees either rollover unused funds to the next year or forfeit them to the employer, depending on the plan's design.

Also, if the plan allows, terminated employees and retirees can spend funds after they have left the company. For maximum coverage, Health Reimbursement Accounts can be paired with Flexible Spending Accounts, although employees cannot request reimbursement from both accounts for the same expense.

Unlike Medical Spending Accounts, employers do not need to pre-fund Health Reimbursement Accounts at the beginning of the coverage period. This improves cash flow, while also protecting companies from employees who use more funds than they contribute.

Further, contractors that perform services for public owners can fully fund their Health Reimbursement Accounts to a welfare benefit trust and receive credit under the Davis-Bacon Act or the applicable prevailing state wage law.

In many cases, employers can reduce their health insurance premiums by 10-15% when they combine a high co-pay and high deductible plan while self-insuring employee deductibles or co-pays that limit annual reimbursements.

The Risks of Health Reimbursement Accounts

While health insurance premiums are lower, the employer assumes responsibility for funding all eligible claims under the Health Reimbursement Account. The Health Reimbursement Account must also meet ERISA, HIPAA, and COBRA requirements.

Because of federal regulations, employers should seek outside assistance to address employee issues and ensure compliance.

Conclusion

All three accounts (Flexible Spending, Health Savings, and Health Reimbursement) empower employers to create attractive, tax-advantaged benefit packages for employees. And, on some level, these accounts also place some financial responsibility for healthcare back into the hands of employees. BP

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