# HEALTH CARE FOR THE BOTTOM LINE: Alternatives to FLEXIBLE SPENDING ACCOUNTS

BY JOHN HIGGINS

The Flexible Spending Account (FSA) has gained popularity with employers in recent years as a way to cut costs while still offering a full range of valuable benefits with a significant tax advantage. But as attractive as the tax benefits of an FSA are to employees and employers alike—it also poses risks for both. Employees, for instance, find it increasingly difficult to manage funds adequately—often losing money at the end of a coverage period as a result of overestimating what they need to cover eligible medical expenses during the course of the year. And employers run the risk of paying out medical benefits that are not fully recouped if an employee leaves the company.

Alternatives, however, can help a contractor realize all the benefits of an FSA while also minimizing its risks. Depending on the organization and its ultimate goals, an employer can opt to implement a health savings account (HSA) or health reimbursement account (HRA).

### HEALTH SAVINGS ACCOUNTS

A health savings account (HSA) is a tax-exempt trust or custodial account established specifically to pay for qualified medical expenses. An HSA only can be used with a high-deductible health plan.

Funds accessed through an HSA are not taxed if used for qualified medical expenses, including health insurance under COBRA or qualified long-term insurance. Contributions belong to the employee—any money not spent at the end of the coverage period remains in the account and unused dollars accrue interest on a tax-free basis. Funds in an HSA can be left to a surviving spouse to cover qualified medical expenses. When there is no surviving spouse, remaining dollars become part of the estate and are taxable at that point.

Additional coverage can be provided through an FSA or HRA when it is limited and does not include benefits that fall under the minimum deductible of the high-deductible health plan.

**Contributions**

- Employers and/or employees may make contributions to an HSA.
- Contributions made by employees and their family members are tax-deductible.
- Employees enrolled in a cafeteria plan can make pre-tax contributions through a salary-reduction plan.
- Contributions made by the employer are not taxed to the business or the employee, but must be reported on the employee's W-2 form.
- If the employer makes contributions to

an HSA, comparable contributions must be made for all participating employees.
- The maximum contribution, calculated monthly, is one-twelfth of the lesser of the annual deductible, or $2,650 for an individual or $5,200 for a family.

### Eligibility

The primary qualifier for participation in an HSA is that an individual must be covered by a qualifying high-deductible health plan that:
- has an annual deductible of a minimum of $1,000 for individual coverage or a minimum of $2,000 for family coverage;
- includes an out-of-pocket limit of $5,100 for individuals or $10,200 for families, excluding premiums;
- does not offer office visit co-pays or prescription drug co-pays; and
- typically does not include any other health coverage.

State-mandated coverage for some preventative care might not be recognized under an HSA unless it includes:
- periodic health evaluations;
- routine prenatal and well-child care;
- child and adult immunizations;
- tobacco cessation;
- some obesity weight-loss programs; or
- certain screening services.

HSAs are subject to non-discrimination rules set forth in IRC 105 (h). However, people eligible for Medicare cannot open or participate in an HSA.

### Advantages

Because funds belong to a participant for life, an HSA can be an effective retirement planning tool, establishing savings for future qualified medical and health care expenses.

An HSA can be offered through an employer, or individuals can opt to open an HSA on their own providing that their group coverage meets the definition of a high-deductible health plan.

### Disadvantages

Under an HSA, prescription drugs may not be handled with a co-pay or drug card. Drug-related expenses go toward the deductible of a high-deductible health plan or alternatively may be covered under a separate high-deductible plan. Essentially, prescriptions must be paid for in-full until the deductible is met.

Individual participants are personally responsible for using HSA funds only for approved medical expenses. Participants must keep detailed records of purchases made through an HSA. Funds used for ineligible expenses must be reported as income and are subject to an additional tax of 10 percent for those under age 65. Any question of eligibility or validity of an expense could potentially result in an individual audit.

## HEALTH REIMBURSEMENT ACCOUNT

A health reimbursement account (HRA) reimburses employees for qualified medical expenses including co-pays, deductibles, office visits, vision care, prescriptions and dental care, as well as health insurance premiums for COBRA.

Several plan designs are available with an HRA, enabling employers to choose a structure that works best for their organizations.

A First Dollar Bridge plan design, which is usually combined with a high-deductible health plan, helps bridge the gap between out-of-pocket expenses and insurance coverage.

The comprehensive plan pays for all qualified medical expenses that are not covered by an existing health insurance plan.

A restricted plan can be set up so that only very specific expenses like vision, dental or prescriptions are covered.

Regardless of what type of plan design an employer chooses:
- reimbursements are not included as part of an employee's gross income;
- the employer may elect to roll over funds to the next year if they are not used; and
- employers sometimes can deduct a portion of their plan-related costs as a business expense.

For additional coverage, HRAs can be combined with FSAs as long as expenses remain separate and are never reimbursed from both accounts.

### Contributions

- Contributions are made solely by the employer, and a separate account is not required.
- There are no contribution limits, although employers may choose to set limits.

### Eligibility

HRAs are subject to non-discrimination rules set forth in IRC 105 (h).

### Advantages

When paired with a high-deductible health plan, HRAs can lower a company's overall health insurance costs.

Certain HRA providers may use a direct debit card for qualified expenses, significantly lowering the time and cost associated with administration. When the card is swiped, expenses are qualified and account balances are checked on the spot. If approved, payments are pre-authorized and the health care provider is paid via ACH debit, automatically deducting funds from the HRA. Employers can review transactions and account information online.

## HSAs AND HRAs COMPARED

The type of plan that will work best for a contractor depends entirely on its needs and objectives. Overall, HRAs offer the flexibility that employees and employers have found with more traditional FSAs without the risk of losing unused funds at the end of the coverage period. In general, employers that offer HRAs say they have significantly lowered costs while effectively increasing employee satisfaction.

HSAs, on the other hand, can be attractive for employers interested in minimizing administrative costs because the plan is handled outside the firm by a custodian or trust. HSAs can help organizations make the most of their employee cost-sharing programs.

With the introduction of these two variations of an FSA, keeping abreast of the various benefits available becomes increasingly difficult. By forming a partnership with an employee benefits specialist, a company can offer its employees the best possible benefits while also protecting the bottom line. Look for an advisor with a proven track record and who is up-to-speed on the current landscape.

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